# EUROGAS

Eurogas

**EUROGAS** CORPORATION
2007 ANNUAL REPORT

**INTERNATIONAL ENERGY PROJECTS**
Spain: Underground Natural Gas Storage
Tunisia: Offshore Exploration and Development

# PROFILE

Eurogas Corporation is a Calgary, Canada-based company whose common shares trade on the TSX-Venture Exchange under the symbol EUG. Eurogas is focused on creating long-term value through the development of high-impact energy projects. The Corporation is developing a major underground natural gas storage facility in Spain, and conducting exploration and development programs for oil and natural gas offshore Tunisia.

## Annual General Meeting

The Annual General Meeting will be held at 2:30 p.m. (Eastern Daylight Time) on Thursday, May 22, 2008 in the Dundee Corporation Boardroom, 28th floor - #1 Adelaide Street East, Toronto, Canada. Shareholders are encouraged to attend. Those unable to attend should complete and return the form of proxy.


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# PRESIDENT'S LETTER TO SHAREHOLDERS

Since I wrote to you in last year's annual report, Eurogas has undertaken significant strategic initiatives in both Spain and Tunisia. These actions have moved the projects forward on a sound financial and technical basis, transformed the Corporation's financial position and enabled the Corporation to move towards its corporate goal of creating long-term value through the development of high-impact energy projects.

## CASTOR UNDERGROUND NATURAL GAS STORAGE PROJECT

In October 2007, work was completed on the Front End Engineering and Design (FEED) study. The FEED study produced detailed design specifications for the facility and was used to update the estimated cost of the project of approximately $2 billion, and will be used as the basis for fixed price, date-certain Engineering, Procurement and Construction (EPC) contracts.

In December 2007, the Corporation entered into agreements with ACS Group (ACS) and Enagas, S.A. (Enagas), two of the largest companies in Spain, for the development of the Castor project. Given the growing size of the project and the reduced liquidity in global financial markets, coupled with regulatory factors in Spain, Eurogas management and Board of Directors concluded that the best course of action available was to invite politically and financially important Spanish partners into the project. The Corporation will retain significant ownership and receive reimbursement of most of the capital investment incurred to date without further funding requirements through completion of the underground gas storage (UGS) facilities. The agreements require that the Castor development concession be granted by the Spanish government prior to June 20, 2008 or the transaction could be reversed. At the time of writing of this report, the concession had not been granted.

The key features of the agreement are:

- ACS increases its equity ownership in Escal UGS S.L. (Escal), the Spanish operating company, from 5 percent to 66.7 percent. Castor Limited Partnership (CLP), which owns 95 percent of Escal and which Eurogas controls through its 73.7 percent ownership, reduces its ownership to 33.3 percent. The agreement thereby results in Eurogas having an indirect ownership position in Escal and the Castor project of 24.6 percent;
- Upon completion of construction, ACS will sell 50 percent of its 66.7 percent interest to Enagas, Spain's natural gas system operator, on a pre-established valuation formula;
- During the project's development phase ACS will control all facets of the project's implementation. It will have six of the nine seats on the Escal board. CLP will have two and Enagas one. Upon Castor's completion and inclusion in Spain's natural gas system, each party will be allocated seats on a basis proportionate to its equity.
- Eurogas will receive approximately $40 million, as reimbursement of past costs and repayment of loans by CLP minority partners, in cash within 25 days from the grant of the Castor development concession, the key government approval needed to commence construction of Castor;

*A project that started as a concept more than a decade ago of transforming a depleted oil reservoir off the northeast coast of Spain into a useful component of the national energy infrastructure has now been brought to the cusp of implementation.*

- ACS will provide or arrange for all funding of Castor until its formal start-up, currently estimated at approximately $2 billion.

- CLP gains an attractive strategic option with the right for a period of 180 days to sell its interest to ACS and Enagas at the same value as ACS' sale to Enagas; and

- In whatever form ACS funds Escal, CLP will have the right to 33.33 percent of the operating Castor facility's distributable cash flows, and will have the right to 33.33 percent of the equity of Escal and of any subordinated loans from ACS to Escal.

This agreement is a strategic achievement of great significance for Eurogas' shareholders. By cementing the participation of ACS, Spain's number-one construction company (a step we initially took in 2006) and bringing on board one of Spain's key energy utilities, we have improved the probability that the largest underground gas storage project in what has been Europe's fastest growing natural gas market will be built and will enter service as a regulated utility generating cash flows for decades to come. With the recovery of past investment, Eurogas will have minimal investment in the Castor project and will have no further capital obligations until the completion and start-up of the UGS facility.

## MAXIMIZING SHAREHOLDER VALUE

A project that started as a concept more than a decade ago of transforming a depleted oil reservoir off the northeast coast of Spain into a useful component of the national energy infrastructure has now been brought to the cusp of implementation. The intervening years were full of risk and uncertainty. The project could have failed in a number of ways and often the progress was slow and laborious. However, the Corporation, with the crucial support and commitment of the shareholders, and with the vision and entrepreneurship of its small founding management team, persevered and held to its strategy. While moving the project forward on technical and regulatory levels, our strategic objective was always to build and retain maximum attainable value for the shareholders in a project that grew over the years in regulatory complexity, technical scope and cost.

The Castor project has enjoyed an improving risk profile in recent years. This is due to the positive results of various technical studies, Spain's favourable regulatory climate and the government's and energy industry's acceptance of natural gas storage as necessary for energy security and the efficient operation of a modern, market-oriented natural gas system. Over the years Eurogas was able to elevate Castor to become a key component of the natural gas storage plan for Spain. With 1.9 billion cubic metres (67 bcf) of storage capacity and a daily retrieval rate of 25 million cubic metres (880 million cubic feet), Castor would be able to fulfill one-third of Spain's requirement for natural gas storage volume and daily balancing.

## ATTRACTING LARGE INDUSTRY PARTNERS

Notwithstanding the attractive technical and business risk profile of Castor, we concluded last year that the new vulnerability of the financial markets was such as to make it difficult for a company the size of Eurogas to raise the required non-recourse project financing, without injecting significantly more equity and providing potentially onerous and dilutive guarantees. These evolving conditions motivated Eurogas to seek greater equity investment by one or more large industry players. We concluded that following this route would further strengthen the potential of Castor proceeding to completion and entering service by end of 2010, a politically important target.

ACS is the largest construction company in Spain, with annual revenues of approximately €20 billion. It is a global leader in the construction and operation of infrastructure, including in the areas of oil and natural gas, liquefied natural gas, regasification, and installation of offshore platforms and topsides. ACS has the strengths needed to lead the engineering and construction phases and to arrange the financial resources required to meet the completion date target.

Upon our initial agreement with ACS in 2006, the Corporation immediately undertook the FEED study, a technical milestone in moving the project forward which was recently completed. ACS has also been retained as the EPC contractor.

Enagas is Spain's largest natural gas transportation, regasification and storage company and the technical manager of Spain's natural gas system. Its facilities include over 7,600 kilometres of high-pressure natural gas pipeline and three regasification plants with total storage capacity of 1.3 billion cubic metres. Enagas manages two underground natural gas storage facilities, Gaviota and Serrablo, and was recently awarded the concession for the exploitation of the Yela onshore gas storage facility. Enagas brings operating expertise and political depth to the ownership group even prior to becoming a shareholder.

These new strategic alliances will align Eurogas' interests with those of key players in Spain's natural gas infrastructure and, importantly, in the future evolution and growth of the Spanish gas industry.

## SFAX PERMIT – TUNISIA

Eurogas' founding purpose was to seek large-scale, high-impact international energy projects. Over the years, Eurogas' involvement in Tunisia has evolved from onshore wildcatting for potentially very large prizes – albeit at high risk and, unfortunately to date, without commercial success – to lower-risk development of oil prospects that in the past were drilled by major operators and tested oil but were abandoned on the 1 million acre Sfax permit, in which the Corporation held a 45 percent working interest on December 31, 2007.

Over the past three years, Eurogas has taken the Sfax permit from the initial evaluation stage, through 3D seismic and detailed prospect development, to the point where drilling can take place. The strategy was two-fold: to develop the three structures that previously tested oil and to retain a third party to explore the unappraised acreage. Three 3D seismic programs covering over 900 square kilometres have resulted in the selection of drilling locations at Ras El Besh and Jawhara. The much larger and barely explored surrounding area holds many intriguing features that have been defined by the seismic recently acquired under an expired farmout arrangement, and which we intend to explore over the coming years.

During 2005, Eurogas and Atlas Petroleum Exploration Worldwide Ltd. (APEX) converted the Sfax prospecting permit to an exploration permit which included a commitment to drill one well and acquire seismic data. Also in 2005, Eurogas and its operating partner applied for an exploitation concession (the REB Exploitation Concession) over the Ras El Besh prospect.

On April 8, 2008 the Corporation and its operating partner, APEX, entered into a farmout agreement with Delta Hydrocarbons B.V. (Delta) covering the entire permit area, including acreage under a recently expired farmout arrangement, as well as the three prior prospects that tested oil, including Ras El Besh, which were excluded from the previous transaction. The prior farmee had the option, until April 1, 2008, to commit to drill an exploration well by December 31, 2008. As they did not elect to proceed, they forfeited all rights to conduct work or to receive any interest in the area.

Under the new farmout agreement, which is subject to the approval of the Tunisia state oil company (ETAP) and the government of Tunisia, Delta has committed to spend US$125 million on Sfax development for a 50 percent participation in the operation. The partners have agreed to a work program which includes drilling the Ras El Besh 3 well as the first of a three-well drilling program which is scheduled to commence immediately. After completion of two wells on the Ras El Besh prospect the drilling rig will move to the Jawhara prospect and drill an appraisal well while installation of production facilities is underway at Ras El Besh. The work program also includes the acquisition of facilities as and when required.



*Over the past three years, Eurogas has taken the Sfax permit from the initial evaluation stage, through 3D seismic and detailed prospect development, to the point where drilling can take place.*

***With a successful rights issue and regulatory approval for the Castor and Sfax transactions, Eurogas will find itself looking to the future from a position of financial strength.***

Included in the US$125 million and as part of the transaction, Eurogas and APEX will be entitled to repayment of past exploration costs incurred on the Sfax permit, of which approximately US$11 million is net to Eurogas.

Upon Delta spending the committed amount of US$125 million, Eurogas will own a 22.5 percent participating interest in the permit; APEX would have a 27.5 percent participating interest, and Delta would own a 50 percent participating interest. APEX will continue to serve as operator. After Delta has expended US$125 million, the project reverts to a joint-venture participation for future expenditures and Eurogas will be responsible for its 22.5 percent share.

Delta is a recently formed oil and gas company based in Amsterdam (The Netherlands) and is focused on maximizing value from discoveries and mature assets.

The drilling of the Ras El Besh 3 well will satisfy the commitments of the Sfax exploration permit, and also trigger the formal grant of the Ras El Besh exploitation concession.

## SUMMATION

Thanks to a strong financial position at the start of 2007, the Corporation was able to continue its crucial investment in both Castor and Tunisia which was necessary to maintain its strategic position in the properties. However, by March 2008 the financial position of the Corporation had changed; the Corporation had drawn on its line of credit, the Castor project had yet to receive the development concession and a federal election in Spain created further uncertainty as to timing of the signing of the concession and therefore the timing of the receipt of the cash payment associated with that agreement; and in the Sfax property the Corporation was facing significant investment commitments in the very near term. The Corporation therefore decided to proceed with a one-for-four common share rights offering at $0.97 per share. If fully subscribed, the issue will raise approximately $30 million. Dundee currently owns approximately 51 percent of the Corporation's common shares and has indicated that it will subscribe for its share of the rights issue. Both the Castor and Sfax transactions are subject to regulatory grants and approvals as a precondition to the release of cash funds associated with each transaction (approximately $40 million for Castor and $11 million for Sfax). We believe that the regulatory conditions will be fulfilled shortly.

With a successful rights issue and regulatory approval for the Castor and Sfax transactions, Eurogas will find itself in a position unique in its corporate history. First, the Castor project is in capable hands with the participation of strategic partners – providing Castor, quite simply, its best prospects ever for success. Second, Eurogas has found a new partner to fund appraisal wells and develop the Ras El Besh and Jawhara prospects. Finally, Eurogas finds itself looking to the future from a position of financial strength.

Thanks are due to Eurogas' shareholders for their patience and commitment over this multi-year period of project conception, planning and development. We are particularly grateful to Dundee Corporation for standing behind Eurogas at various crucial times, and always being ready to assist in the implementation of Eurogas' business plan with concrete financial support and guidance. Thanks to all of the staff of Eurogas for their diligence and loyalty, and to the staff in Madrid for their solution-oriented management of the Castor project, their positive spirit and their productive work with Castor's new majority partner.

M. Jaffar Khan
President and Chief Executive Officer
April 11, 2008

# SPAIN:
# CASTOR UNDERGROUND GAS STORAGE PROJECT


# 1.9

*Billion Cubic Metres (67 Billion Cubic Feet)*

## STORAGE CAPACITY

The Castor structure is 5 kilometres in length, 2.5 kilometres wide and up to 250 metres thick.

The underground reservoir's size and porosity provide a large storage volume equivalent to 14 LNG transportation tankers.

# 25

*Million Cubic Metres/Day (882 Cubic Feet/Day)*

## WITHDRAWAL RATE

The Castor project will provide approximately one-third of Spain's UGS deliverability requirements and virtually 100 percent of the region's UGS capacity.

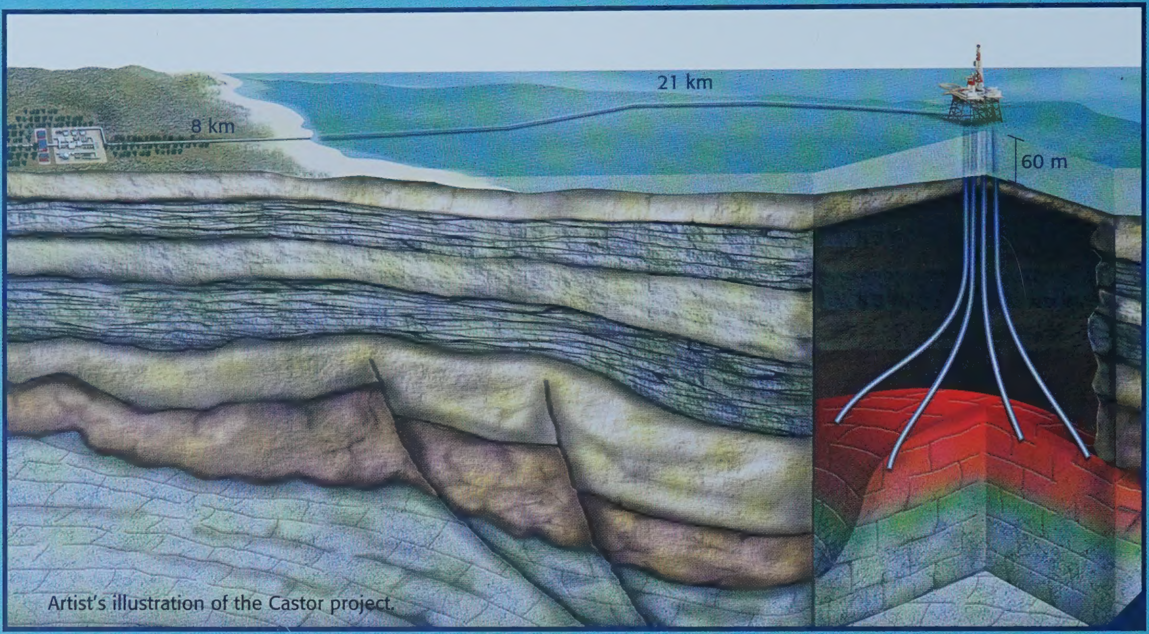
The high daily withdrawal rate is equivalent to a large LNG regasification plant – an important competitive advantage.

# $2.0

*Billion to Design, Construct and Commission*

## INVESTMENT COST

The Castor project is a significant investment in supporting Spain's natural gas infrastructure. The FEED study provided detailed design specifications of the facility and an updated cost estimate.



Artist's illustration of the Castor project.



## PROJECT BACKGROUND AND 2007 ACTIVITIES

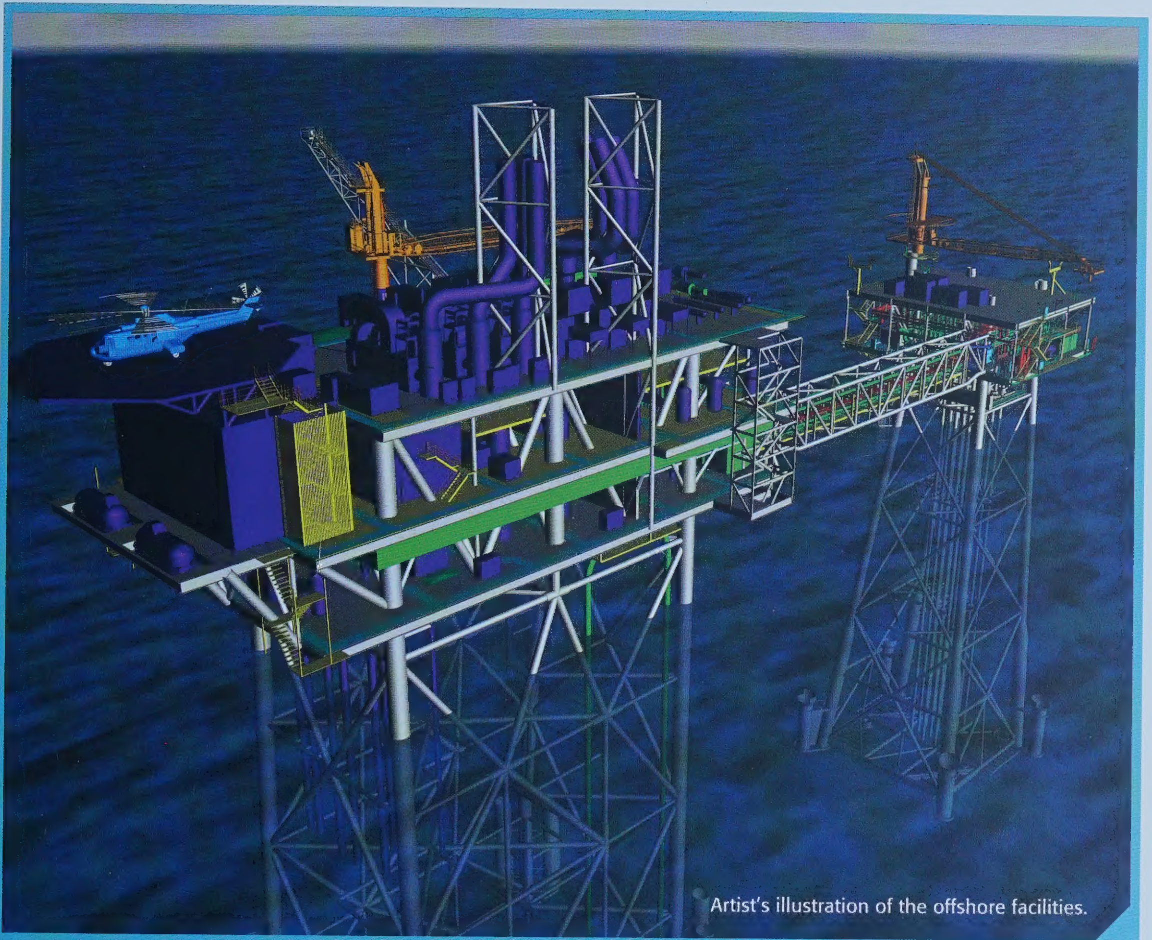
Two-thousand-and-seven has been a pivotal year in the development of the Castor underground gas storage project. First, the FEED study was completed, providing detailed design specifications of the facilities and determining the expected cost of the project. Second, corporate agreements with two major Spanish companies has put the project on firm footing for gaining regulatory approval, financing and construction. Based on the FEED study, the Castor project is estimated to cost approximately $2 billion.

Following the tripartite agreement with ACS, the largest construction company in Spain with extensive experience in the construction of infrastructure projects, and Enagas, the largest company in the gas transportation and distribution industry in Spain, Eurogas will retain an indirect 24.6 percent non-operating interest in the Castor UGS project. This interest will be held through Eurogas' 73.7 percent interest in the Castor Limited Partnership (CLP). CLP will own 33.3 percent of Escal UGS S.L., which is the operating company developing the Castor project.

The Castor development permit, if approved, would be granted for a period of 30 years with two extensions of 10 years each, providing 50 years of steady cash flow. The regulated revenue would consist primarily of three components: the repayment of capital over 10 years followed by an ongoing payment equal to half that amount for the life of the concession; a return on net investment equal to the Spanish 10-year bond rate plus 3.5 percent; and a payment for operating expenses that should on average be equal to actual operating costs.

The Corporation has developed the Castor project over a period of many years, guiding it through numerous technical and regulatory steps. The project is now poised to achieve the most important regulatory approval – the development concession. The Castor project creates significant long-term value for the Corporation and once it enters service as a regulated utility will provide stable, long-term cash flow for Eurogas' shareholders.

***The Castor project creates significant long-term value for the Corporation and will provide stable, long-term cash flow for Eurogas' shareholders.***



Artist's illustration of the offshore facilities.



## The FEED study calls for two platforms offshore in 60 metres of water:

### WELLHEAD PLATFORM

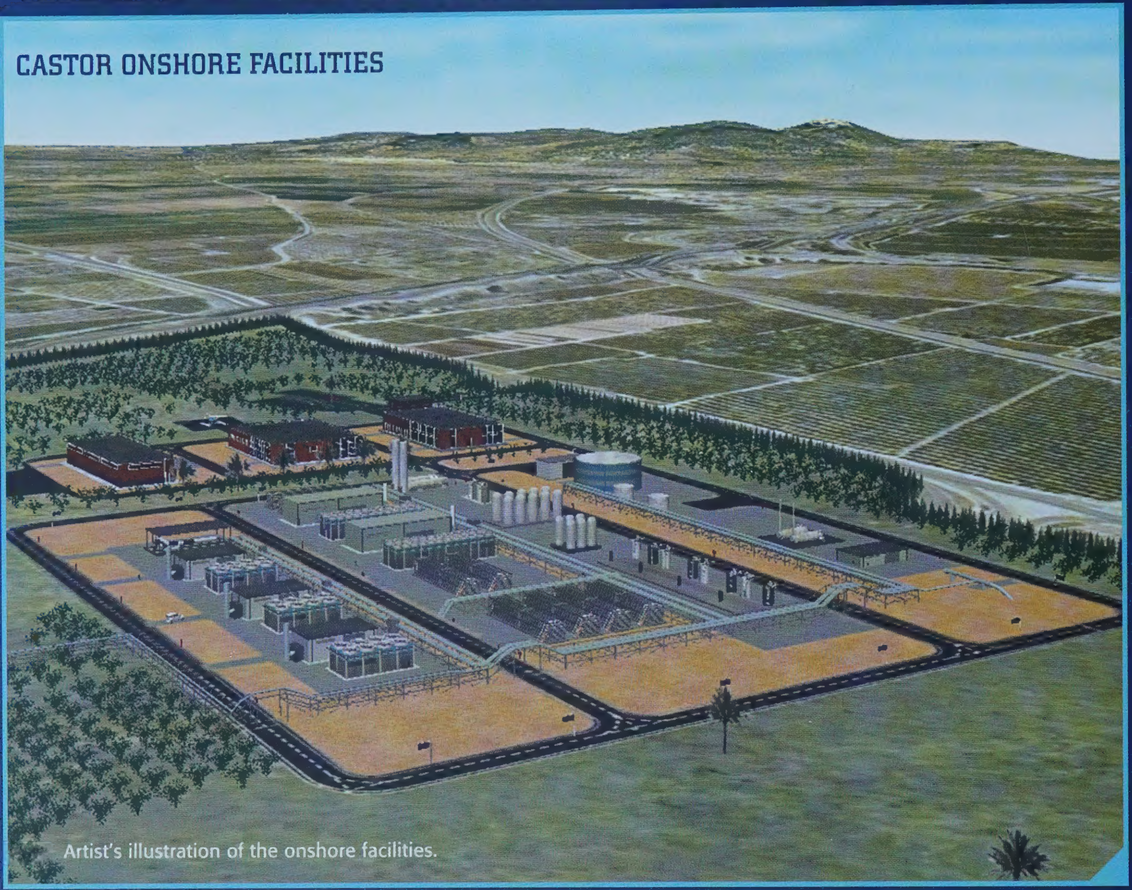
First to be built and installed is the Wellhead Platform from which all wells are to be drilled. Being the smaller platform of the two, it will be the first to be installed which will enable drilling of wells while the larger Processing Platform is under construction.

### PROCESSING PLATFORM

Facilities on the Processing Platform include gas compression for the injection cycle. The equipment for the withdrawal cycle includes liquid removal and re-injection, and dehydration facilities.

### GAS STORAGE WELLS

The Castor project utilizes eight wells for gas injection/retrieval operations, four for monitoring/observation and one for liquids disposal.



Artist's illustration of the onshore facilities.



## MARKET CONDITIONS

The natural gas industry in Spain has undergone continued, rapid development over the past 15 years, driven by a number of factors including economic growth, market liberalization, the versatility and cost effectiveness of natural gas, and growing environmental awareness. Gas is a growing component of Spain's energy mix and now provides about 20 percent of Spain's primary energy supply. Within the EU, Spain is regarded as having the fastest growing natural gas market with consumption growing an average of 12.3 percent annually over the last ten years.

The rapid and continuing increase in natural gas usage has created the need for additional gas infrastructure, including additional gas storage. The Spanish government has clearly signalled that it considers strategic natural gas storage to be a required component of Spain's energy infrastructure and important to the nation's security of supply. Castor was officially recognized in the Spanish energy infrastructure plan in 2002 and was elevated to "A Urgent" status in 2006.

The Spanish government has acted to approve a number of natural gas storage facilities dispersed around the country that will contribute to daily balancing and security of supply. One new project, Yela, was recently approved for construction, and an existing facility, Gaviota, was recently approved for expansion. Castor remains the largest in capacity and, thanks to its karstified carbonate reservoir, offers the highest withdrawal rates from its gas storage wells.

Following these additions and expansions, Castor will represent one-third of Spain's combined natural gas storage capacity and deliverability. The storage capacity at Castor will be equivalent to the cargoes of 14 liquefied natural gas (LNG) tankers. It will be the only fixed storage facility situated within the highest-demand region of Spain, the industrialized northeast coast. This region includes the cities of Barcelona and Valencia and accounts for nearly half of Spain's natural gas consumption.

# CORPORATE STRUCTURE AND RESPONSIBILITIES




The December 20, 2007 tripartite agreement among CLP, ACS and Enagas enabled Eurogas to secure the participation of two of Spain's foremost corporations in the Castor project. The agreement is detailed in the Management's Discussion and Analysis. The resulting corporate structure is depicted in graphical form above. Eurogas initially became involved with ACS in October 2006 when ACS was selected to undertake the FEED study and took a 5 percent equity position in Escal UGS.

The highlights of the agreement are:

- Each of CLP, ACS and Enagas will hold 33.3 percent of Escal with ACS taking the lead in managing the project. Eurogas holds 73.7 percent of CLP and so will have a 24.6 percent interest in the Castor Project.

- Within 25 days of the grant of the development concession, ACS will repay to CLP approximately $40 million, which is most of its prior investment in the Castor Project.

- ACS will be responsible for the funding of the Castor project, including providing all required guarantees. CLP will not be required to put any equity or debt funds or provide any warranties required by project finance lenders or to provide any bridge financing.

- The Spanish staff of Escal remains in place and serves as the project's technical experts and administrators. They will continue to run the project at the direction of ACS, and ACS will provide additional expertise as needed.

- If the Castor development concession is not granted by June 20, 2008 the transaction could be reversed.

Given its long background in conceiving and technically proving up the Castor project, Eurogas will continue to supply technical expertise in the areas of geology, geophysics and drilling/completions of wells.

## THE AMPOSTA RESERVOIR

One of the most attractive features of the Castor project is the high quality of its underground storage reservoir. Gas storage reservoirs must have a number of characteristics if they are to serve as efficient storage facilities and the Amposta reservoir amply fulfils the necessary criteria. It was discovered in 1970 and produced over 56 million barrels of oil until 1989, when it was abandoned. Five kilometres long by 2.5 kilometres wide, it lies at a depth beginning at 1,700 metres below the seabed, with an original oil-water contact measured at 1,940 metres.

Eurogas recognized that the Amposta reservoir held potential for conversion to UGS operations and acquired the Castor permit in 1996, enabling the Corporation to launch a series of studies to substantiate its suitability for natural gas storage. The structure is comprised of highly porous and karstified Cretaceous-aged limestone, with extensive fracturing and brecciation. Reservoir pressure is supported by a large, underlying aquifer that results in an active water drive, or natural pressure maintenance. Finally, the reservoir is sealed by 100 metres of tight shale and siltstones. These characteristics add up to offering both the volume of storage capacity and the high rate of deliverability required for successful commercial gas storage operations.

In 2005, Eurogas drilled the Castor 1 appraisal well. Its log data and high-rate flow test confirmed the porous and permeable nature of the reservoir. It also confirmed that the overlying Castellon Formation is impermeable and will act as an effective seal for the gas storage reservoir.

A 3D seismic survey conducted in 2005 led to an improved understanding of the reservoir's structure and characteristics and helped in choosing the locations for the additional 12 planned wells. The Castor project will utilize eight wells for gas injection/retrieval operations, four for monitoring/observation and one for liquids disposal.



## FEED STUDY

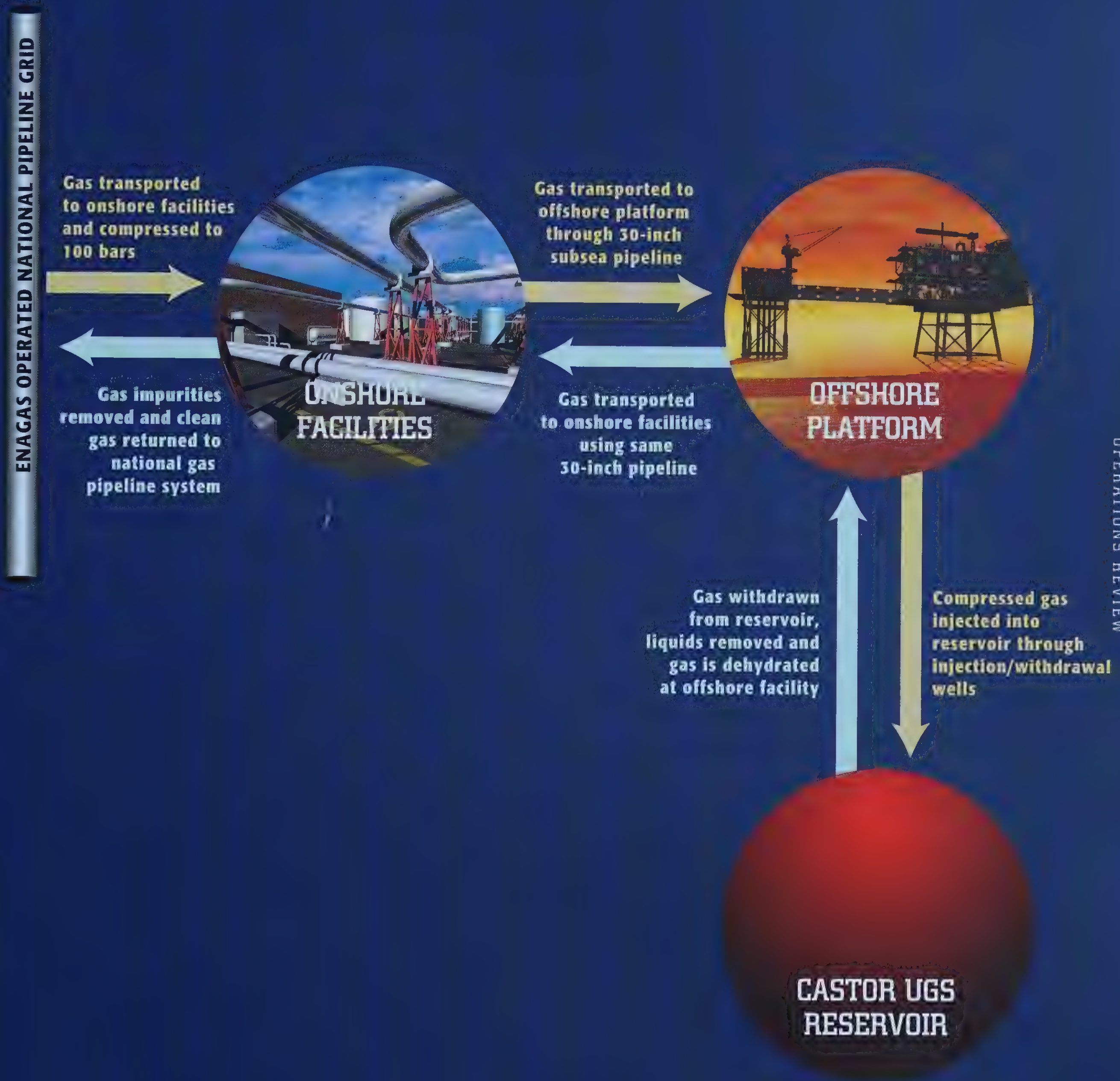
Just as the development concession is the key regulatory permit enabling the Castor project to proceed, so the FEED study is the crucial technical document among the many studies and reports that have been written over the past number of years. The FEED study was conducted by ACS. It began in October 2006 and the report was delivered in October 2007.

The FEED study serves as the basis for the EPC contracts. The process included reviews of all technical aspects of the project, including a critical review of key components to ensure their compatibility when integrated. The work product included setting ranges for key elements: specifications, capacities, processes, time lines and costs. Individual component time lines were integrated into an overall project critical path.

The study's findings led to several improvements in the project's design. One was to move from a single platform concept to a two platform concept – one platform for the wells and a second for major process facilities. This change will accelerate the drilling and tie-in of the 13 wells while the processing platform is constructed off-site. A second major change was to install gas injection compressors both onshore and offshore. Adding offshore compression made it possible to lower the working pressure in the subsea pipeline to accommodate standard 30-inch pipe. This avoided a lengthy queue in delivery of otherwise specialized pipe. A third change was adding acid-gas removal facilities at the onshore site to ensure that gas retrieved from the UGS reservoir meets pipeline specifications when it is returned to the national gas grid.

An additional change was relocating the onshore facilities a further 6 kilometres inland. Besides distancing the plant from a local community, the new site at 27.7 hectares is larger than the original 7.8-hectare location and provides an expanded area for the facilities called for in the FEED study.

# THE UGS PROCESS



## CONSTRUCTION

Receipt of the development concession and activation of the tripartite agreement will clear the way for construction of the Castor project. ACS will undertake the EPC contract, which has three main components: construction of the offshore wellhead and processing platforms, construction of the onshore facilities, and the installation of the onshore and offshore pipelines. The first item of business upon receipt of government approval is to order the long-delivery equipment items in order to accelerate drilling and minimize the period to start-up of the gas storage operation.

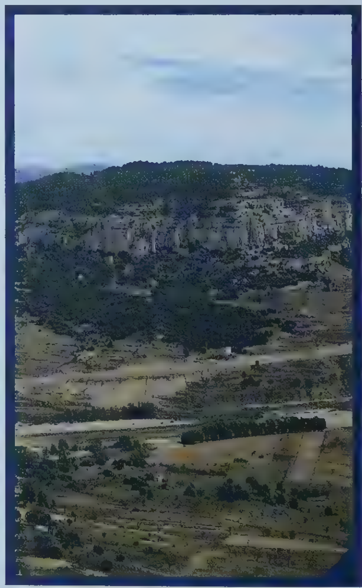
Construction contracts for the offshore wellhead platform will be tendered immediately upon receipt of the development concession. ACS retained the U.K. branch of Mustang Engineering L.P., a large, reputable engineering company based in Houston, Texas, to provide the detailed engineering of the offshore platforms. Escal has been monitoring the offshore drilling market for the past two years and will tender the drilling contract. The geological work required for drilling has been completed and trajectories of the new wells have been planned. All wells will be drilled from the wellhead platform, with the most distant wells being located laterally by up to 2,000 metres or 3,000 metres total length, inclined at up to 60 degrees.

Construction, transport and installation of the wellhead platform are expected to take approximately one year. The platform will then be available for drilling and tying in of 13 gas storage wells. Concurrently, construction of the onshore facilities, offshore process platform and pipelines will be underway. This is expected to take two to two-and-a-half years. The completion date for the Castor project now depends on project approvals, the deliverability of long-term equipment and on the construction and installation schedules for the facilities and pipelines.



Landing site for the subsea pipeline.

Production tests on the Castor 1 well confirmed the high quality of the reservoir for gas storage.

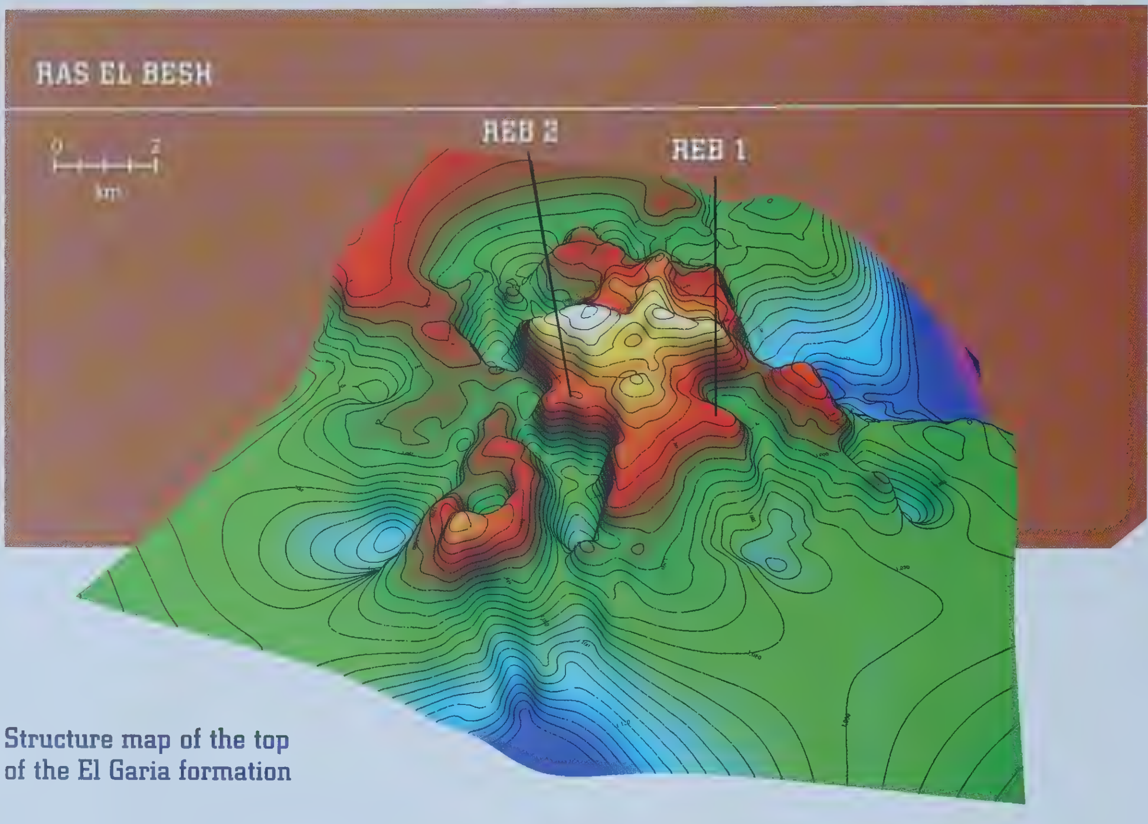


This onshore outcrop is similar to the Amposta reservoir which provides gas storage for the Castor project.

# TUNISIA:
# SFAX EXPLORATION PERMIT


Tunisia is located on the north coast of Africa and has a flourishing oil and gas industry.

As of December 31, 2007 Eurogas held a 45 percent working interest in the 1 million acre Sfax Exploration Permit where a three-year work program identified leads and prospects over a significant portion of the development and exploration acreage. Eurogas' near-term goal is to establish a production base from three separate prospects that flow-tested oil. Since the award of the permit in 2005, Eurogas and its operating partner have acquired more than 900 square kilometres of 3D seismic data over three separate areas. The new seismic includes a 348 square kilometre program over the Ras El Besh and Jawhara development prospects, a 520 square kilometre program over exploration leads, and a 45 square kilometre program over the Salloum prospect just off the Tunisian coastline. Eurogas' operating strategy is two-fold: drill and evaluate the three structures that tested oil, and evaluate the exploration acreage.




**Structure map of the top of the El Garia formation**

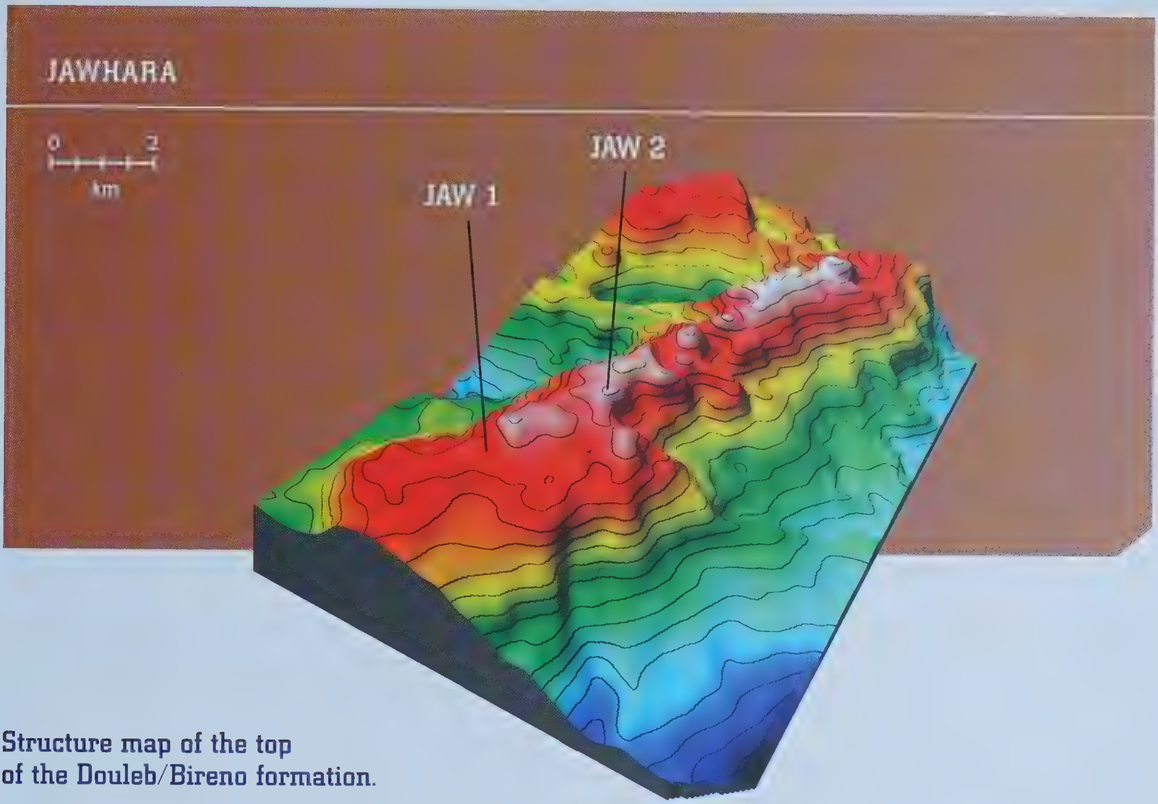


## EXPLORATION AND DEVELOPMENT

The Sfax Exploration Permit lies on-trend with a known hydrocarbon fairway that includes a number of large (1 billion boe or greater ) oil and gas fields, and is directly offset by several large producing oil and natural gas fields of up to 350 million boe in reserves. The prospectivity at Sfax is extensive and numerous medium- to large-sized geological features are detailed by the recent 3D seismic. In addition, exploration leads have been identified on older 2D seismic lines with encouraging shows in adjacent exploration wells.

Exploration wells drilled by prior operators at Ras El Besh, Jawhara and Salloum in the 1970s and 1990s flow-tested oil at daily equivalent rates of 612, 1,200 and 1,800 barrels per day, respectively, but were abandoned. New 3D seismic illustrates that previously abandoned exploration wells at Ras El Besh and Jawhara penetrated the target zones off the crest of the structures and that additional pay sections can be intersected with properly placed appraisal wells. The targets are limestone and dolomite carbonate reservoirs of Eocene and Upper Cretaceous age that lie at depths between 1,700 and 3,000 metres. Tubulars and well equipment, plus the necessary services, have been procured to proceed with the 2008 drilling program.

Revenue from the Sfax permit is based on a production sharing agreement, whereby the concession holders, Eurogas, APEX and now Delta, share the oil production with the government oil company ETAP. The concession holders are responsible for all capital investment and operating costs, and once oil starts flowing are entitled to a share of the oil produced. That share depends on the rate of oil production and is composed of two parts. The first is called "cost oil" and is provided to recover capital and operating expenses. The second is called "profit oil" and is a share of the oil production over and above the cost oil. ETAP receives the balance and is required to pay all taxes, including those of the concession holders, out of their share of production.




**Structure map of the top of the Douleb/Bireno formation.**



## FARMOUT

On April 8, 2008 Eurogas announced that the Corporation and the permit operator, APEX, entered into a farmout agreement on the Sfax Exploration Permit with Delta whereby Delta committed to spend US$125 million for a 50 percent participation in the permit. The partners have agreed to a work program which includes drilling the Ras El Besh 3 well as the first of a three-well drilling program. The partners are negotiating a contract that will allow drilling to commence in the very near future. A success at REB-3 will lead to a development well at REB-4. After completion of the Ras El Besh wells, the drilling rig will move to the Jawhara prospect and drill an appraisal well while the installation of production facilities is underway at Ras El Besh. The work program also includes the acquisition of facilities as and when required.

Included in the US$125 million and as part of the transaction, Eurogas and APEX will be entitled to repayment of past costs, of which approximately US$11 million is net to Eurogas. Upon completion of the work program, Eurogas would own a 22.5 percent participating interest in the farmout lands. Drilling of the first well in the program, Ras El Besh 3, will satisfy the outstanding work commitment on the permit.

The farmout agreement with Delta includes the area covered by a recently expired farmout agreement as well as three prior discoveries, including Ras El Besh, which were excluded from the previous transaction. As disclosed in the March 14, 2008 Eurogas Rights Offering Circular, the prior farmee had the option, until April 1, 2008 to commit to drill an exploration well by December 31, 2008. As it did not elect to proceed, it forfeited all rights to conduct work or to receive any interest in the area.

The farmout is subject to the approval of the Tunisian state oil company (ETAP) and the government of Tunisia. The drilling of REB-3 will satisfy the commitments of the Sfax exploration permit, and also trigger the formal grant of the Ras El Besh exploitation concession.

# MANAGEMENT'S DISCUSSION AND ANALYSIS

This Management's Discussion and Analysis ("MD&A") provides a discussion and analysis of financial condition and results of the operations of Eurogas Corporation ("Eurogas" or the "Corporation") for the year ended December 31, 2007. The following information has been prepared by management and should be read in conjunction with the audited consolidated financial statements for the years ended December 31, 2007 and 2006, together with the accompanying notes ("Audited Consolidated Financial Statements"). This MD&A is based on information available as of March 17, 2008. The reporting and the measurement currency is the Canadian dollar. Financial data has been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") unless otherwise specified.

Eurogas is a Canadian-based company whose common shares are traded on the TSX Venture Exchange (TSXV) under the symbol EUG. During the period, Eurogas carried on activities in Tunisia and Spain. Eurogas is focused on creating long-term value through the development of high-impact energy projects. The Corporation is conducting exploration programs for oil and natural gas offshore Tunisia and is involved in developing an underground natural gas storage facility in Spain (the "Castor Project").

## FORWARD-LOOKING STATEMENTS

Certain information set forth in this document, including management's assessment of the Corporation's future plans and operations, contains forward-looking statements. By their nature, forward-looking statements are subject to numerous risks and uncertainties, some of which are beyond the Corporation's control, including the impact of general economic conditions, industry conditions, volatility of commodity prices, currency fluctuations, imprecision of reserve estimates, environmental risks, competition from other industry participants, the lack of availability of qualified personnel or management, stock market volatility and ability to access sufficient capital from internal and external sources. Readers are cautioned that the assumptions used in the preparation of such information, although considered reasonable at the time of preparation, may prove to be imprecise and, as such, undue reliance should not be placed on forward-looking statements. The Corporation's actual results, performance or achievement could differ materially from those expressed in, or implied by, these forward-looking statements and, accordingly, no assurance can be given that any of the events anticipated by the forward-looking statements will transpire or occur, or if any of them do so, what benefits the Corporation will derive from them. The Corporation disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law.

*All financial units in this MD&A are expressed in Canadian dollars unless otherwise stated.*

# INTERNATIONAL OIL AND GAS PROJECTS

## Spain: The Castor Project

As at December 31, 2007, the Corporation reports a controlling interest in the Castor Project through its 73.7 percent interest in Castor Limited Partnership ("CLP") which owns an interest in Escal-UGS S.L. ("Escal") (Refer to "Business reorganization of Escal" below).

The Castor Project entails the conversion of the abandoned Amposta oil field to natural gas storage operations. The cost of the Castor Project is estimated at approximately $2 billion. The Castor Project was categorized as "A Urgent" in Spain's Energy Infrastructure Plan in 2006 and is one of the first underground gas storage projects intended to be developed under Spain's current energy regulatory regime and, if approved, will become a regulated utility forming a crucial element of Spain's energy infrastructure.

The Castor Project's anticipated significant working gas storage capacity of at least 1.3 billion cubic metres is expected to provide a reserve for seasonal and extraordinary peak demands, as well as the ability to respond to normal daily peak demands. It is also anticipated that in an emergency, approximately 75 percent of the 600 million cubic metres of cushion gas could also be withdrawn, but at a lower rate.

The project's anticipated high delivery rate of 25 million cubic metres per day will contribute strategic storage and reliability of supply to industrial and domestic customers in Spain, and could compensate for any temporary supply shortfall equal to the capacity of the Maghreb pipeline or the Cartagena regasification plant for up to 40 days.

The Castor Project will utilize the abandoned Cretaceous aged carbonate Amposta oil field for gas storage. The Amposta field, which is located 21 kilometres off the eastern Mediterranean coast of Spain, was discovered in 1970 by Shell España, and began producing oil in February 1973. The field was abandoned in 1989 after producing 56 million barrels of oil with less than 1 percent water and a 2 percent drawdown on the reservoir's original pressure of 2,743 pounds per square inch.

During 2007, Escal invested approximately $17.8 million in the project compared to $6.5 million in 2006.

### (a) Engineering and facilities

On October 23, 2006, Escal entered into an Assistance Contract with ACS Servicios Comunicaciones y Energia, S.L. ("ACS"). Under the terms of this contract, ACS began the Front End Engineering and Design Study ("FEED Study") and initiated permitting and licensing services associated with the Castor Project.

In October 2007, work was completed on the FEED Study which produced detailed design specifications for the facility and was used to estimate the cost of the project of approximately $2 billion, and will be used as the basis for fixed price, date-certain Engineering, Procurement and Construction ("EPC") contracts. In May 2007, the Corporation contracted ACS for additional services, including detailed engineering work related to the wellhead platform, information related to long lead-time equipment and project management services.

The FEED Study design includes two offshore platforms, which will be located in waters with a depth of 60 metres, an onshore terminal and a subsea pipeline connecting the offshore platform to the onshore terminal. The proposed gas storage facility is projected to use 13 wells: eight injection/withdrawal wells, four monitoring or observation wells, and one disposal well.

The first offshore platform will be a wellhead platform that will enable drilling of wells prior to installing the main platform. It is anticipated that the use of a separate wellhead platform for drilling will reduce overall development time.

The second platform will contain major process facilities for injection compression and, during the withdrawal cycle, liquids separation, liquids disposal and gas dehydration. Offshore compression will allow the use of standard 30 inch pipe operating at a moderate pressure to transport the gas from the onshore terminal to the offshore platform. Offshore dehydration facilities will remove formation water that in combination with $CO_2$ forms a highly corrosive mixture.

The onshore terminal will consist of two main sections: a compression system for gas injection and a gas treatment system for gas withdrawal which will include facilities for acid gas removal. Gas injection rates will be half the extraction rate. The facilities have been designed to supply gas at the full design rate to the Spanish distribution system within two hours of receipt of notice. A pipeline will connect the terminal to the Spanish national gas distribution system and as such, operations will be directly linked to the national distribution system.

Escal invested $8.3 million on the FEED Study and associated activities during the year (2006 – $1.4 million). Detailed engineering studies in 2007 cost $2.6 million (2006 – $nil). Spending on geotechnical and other technical studies aggregated $2.4 million (2006 – $1.8 million which included reservoir analysis and other technical studies at a cost of $1.1 million).

ACS has been awarded the Engineering, Procurement and Construction contract, subject to contractual terms being approved by future lenders. Eurogas has a Services Agreement with Escal to provide technical and other services on a go-forward basis.

(b) Regulatory process

The project requires successful completion of a complex permitting process, including the grant of the Development Concession.

The Spanish Ministry of Industry has completed the required public review process for the Development Concession, one of the required steps before the Development Concession can be granted. This process provided the opportunity for interested parties to view project documents and submit their comments. As a result of the review process and after consultation with the ministry and the local municipality, Escal has agreed to relocate the proposed onshore facilities to a new site further away from the town of Alcanar. A new site which is approximately three times the size of the original site for the onshore terminal has been identified. Negotiations are underway for the purchase of this property. The change in location is expected to have a negligible impact on the overall cost of the facility.

The Development Concession, if granted, will be through a Royal Decree approved by the Spanish Council of Ministers and published in the official bulletin. In addition to the Development Concession, the primary project permit, a number of secondary permits are also required. Escal has submitted applications for several of these, including Construction Authorization, Occupation of the Marine Domain and the Public Interest Declaration, to national and regional authorities. An updated Environmental Impact Study was also submitted.

### (c) Financing activities

The Corporation's interest in the Spanish oil and gas property is owned through CLP. As at December 31, 2006 the Corporation owned a 73 percent interest in CLP and, accordingly, a 73 percent interest in Escal.

In January 2007, a cash call was issued to the limited partners. Non-controlling unitholders contributed $430,002 of the $641,470 for which they were cash called. As a result, Eurogas' interest in CLP was increased to 73.7 percent as at January 30, 2007.

Pursuant to a meeting of the CLP held on May 17, 2007, the partners agreed to a $28 million cash call. The Corporation funded the non-controlling unitholders' portion of the cash call totalling $7,363,644 by way of demand secured promissory notes receivable with an interest rate of six percent per annum and a term of the earlier of: May 17, 2008; the closing date of a sale by the Borrower of its interest in CLP; 240 days from the date that Escal receives its Development Concession; the date the Castor Project is abandoned; and the date the CLP is dissolved. The notes are secured by a pledge of each of the respective partners' interests in CLP.

In accordance with a Collaboration Agreement entered into in December 2006, ACS acquired a 5 percent equity interest in Escal for an initial payment of $139,445, and entered into a shareholder's agreement related to Escal which included the right to appoint one person to the Board of Directors of Escal on July 26, 2007. Additional consideration was due upon completion of an independent valuation pursuant to project financing arrangements in the amount of 5 percent of the valuation less the initial payment. The Collaboration Agreement would be superseded by the transaction described under *Business reorganization of Escal* below.

### (d) Capitalization of administrative costs

The Corporation and Escal have committed substantial technical expertise and strategic direction to the Castor Project. Administrative costs associated with the project are capitalized as part of the project's pre-development phase of operations. All administrative costs of the Escal office incurred relating to the project during 2007 were capitalized totalling $2.0 million compared to $1.1 million during 2006. A portion of Eurogas' corporate administration is also charged to the Castor Project under service agreements through CLP and the Corporation. During 2007, $1.6 million was allocated to the project compared with $1.7 million during 2006. This includes amounts for capitalized stock based compensation of $717,879 in 2007 (2006 – $345,214).

## Business reorganization of Escal

On December 20, 2007, the Corporation (through CLP) entered into agreements with ACS and Enagas, S.A. ("Enagas") herein referred to as the "ACS Transaction". Under the ACS Transaction, Escal issued shares such that ACS increased its ownership in Escal from 5 percent acquired in August 2007 (see *Financing activities* above) to 66.67 percent, and thereby reducing the interest of CLP, of which the Corporation is a 73.7 percent owner, to 33.33 percent from 95 percent.

The ACS Transaction requires that, in the event that the Development Concession is not granted within 180 days of the execution of the ACS Transaction, CLP will purchase and ACS will sell, at nominal value, a number of shares of Escal such that ACS will have 5 percent ownership and CLP will have 95 percent and the agreements will terminate. There is no assurance that the Development Concession will be granted within such timeframe, or at all.

In accordance with GAAP for such a transaction, the Corporation is deemed to have retained control of Escal, even though the issuance of the new treasury shares of Escal has been legally registered in Spain, until the Spanish authorities approve the Development Concession. Accordingly, the Corporation has continued to consolidate the results and balances of Escal in its financial statements.

Upon the grant of the Development Concession within the timeframe and, therefore, fulfillment of the condition referred to above, the Corporation will change its accounting for its interest in Escal to the equity method and will record an equity investment in Escal whereby the investment will initially be recorded at the carrying value of CLP's proportionate interest in Escal at that date. This will be adjusted by CLP's proportionate share of earnings, losses and other comprehensive income or loss of Escal thereafter.

Until inclusion in the Spanish gas system, the board of Escal will have nine directors allocated as follows: ACS – six; CLP – two and Enagas – one. After completion and inclusion in the gas system, each party will be allocated seats on a proportionate basis to its ownership in Escal.

ACS has agreed that, within 25 days of the grant of the Development Concession, it will repay to CLP most of the amount of its prior investment in the Castor Project. The amount is subject to due diligence which is presently underway and is expected to be approximately €30 million ($43 million). Amounts attributable to non-controlling unitholders of CLP will be applied against the notes receivable and accrued interest due to Eurogas, and as a result, Eurogas is expected to net approximately $40 million from this repayment. A portion of the aggregate funds may have to later be repaid to ACS if the regulatory authorities do not include certain costs in the remuneration base.

ACS shall be responsible for the funding of the Castor Project, including providing all guarantees required, from the day it increased its shareholding in Escal through to the inclusion of the UGS Facility into the Spanish gas system. CLP will not be required to put any equity or debt funds or provide any warranties required by project finance lenders or to provide any bridge financing. Notwithstanding this, CLP's interest in the project will at all times remain at 33.33 percent.

Further, no later than the start-up of the underground gas storage facility, ACS will sell and Enagas will buy 50 percent of the ACS interest in Escal on a pre-established pricing formula at which point CLP, ACS and Enagas will each own 33.33 percent of the equity of Escal.

Under the terms of the ACS Transaction, for a period of 180 days after start-up of the UGS Facility, CLP can sell part or all of its shares to ACS and Enagas, priced on the same basis as the ACS sale to Enagas.

In whatever form ACS funds Escal, CLP will have the right to 33.33 percent of distributable cash flows and will have the right to 33.33 percent of Escal. For this purpose, loans by ACS to Escal will be regarded as equity.

Upon commencement of operations of the UGS Facility, Enagas will assume general responsibility for operations, including monitoring and analyzing the performance of the Operations and Maintenance Contractor. In its capacity as Technical Manager of the Spanish gas system, Enagas will also issue instructions for the operation of the storage facility.

ACS is the largest construction group in Spain and third largest in the world, with revenues in excess of €20 billion. ACS is a global leader in the creation, construction and operation of infrastructure in a variety of industrial sectors such as: oil & gas, LNG (liquefied natural gas) and regasification, power generation, grids and railways. Through its subsidiaries, such as Dragados Off-Shore, it is one of the world leaders in the construction and installation of offshore platforms and infrastructure topsides.

Enagas is Spain's top natural gas transportation, regasification and storage company, and is also the Technical Manager of the Spanish gas system. Its facilities include over 7,600 km of high-pressure gas pipeline and three regasification plants, which have a total storage capacity of 1.3 million cubic metres of LNG. It also manages two underground gas storage facilities, Gaviota and Serrablo, and has recently been awarded a Development Concession for the exploitation of the Yela onshore gas storage.

In the event that regulatory approval is not obtained within 180 days and CLP's interest reverts back to 95 percent, the Corporation will need to assess whether it has experienced an impairment in its property, plant and equipment.

### Tunisia: Sfax Permit

Eurogas is currently conducting exploration programs for oil and natural gas offshore Tunisia in the Gulf of Gabes, where the Corporation holds a 45 percent interest in the 1.0 million acre Sfax Permit. Eurogas is the non-operating partner in the permit. All costs associated with the Sfax Permit are capitalized as part of the pre-production phase of operations.

The Sfax Permit lies within a hydrocarbon fairway that trends from offshore Libya, through the Gulf of Gabes, to onshore Tunisia and includes major oil and gas fields. The Sfax Permit is surrounded by producing oil and gas fields to the west, north and east, including the 330 million barrel Ashtart oil field that lies along the south east boundary.

Previous operators drilled and flow tested oil from three separate structures on the prospect at daily equivalent rates of 612, 1,200 and 1,800 barrels of oil per day. These structures were sub-economic given the low oil price environment at the time and the wells were abandoned.

Following the granting of the Sfax Permit in 2004, the Corporation and its joint venture partner Atlas Petroleum Exploration Worldwide Ltd. ("APEX") acquired a new 3-D seismic program over 348 $km^2$ of the permit, which included the known Ras El Besh and Jawhara prospects that tested oil. The seismic has provided an improved understanding of the geology, which will enable better placement of future wells to maximize chances of commercial production.

During 2005, the Corporation and its joint venture partner successfully converted the Sfax Permit to an Exploration Permit. The four year permit commenced December 9, 2005, and includes a commitment to drill one exploration well at a budgeted cost of US$9.8 million net to Eurogas, prior to December 9, 2009. Failure to fulfill the technical and financial commitments on the permit within the duration of the initial period of the concession will result in cancellation of the permit by Tunisian authorities. The operator has tendered contracts for equipment and services to drill the well ("REB-3"). An estimated 95 percent of the material has been purchased and 95 percent of the required services have been contracted at an aggregate cost of approximately $420,000 (net) to Eurogas as at December 31, 2007. The contracts for the remainder of the equipment and services will be finalized prior to the commencement of the drilling of the REB-3 well which, depending on the operator, is expected to occur in 2008. The drilling contract has not yet been entered into.

Provided all commitments are fulfilled, permit holders are entitled to submit an application at least two months before expiry of the permit to renew the permit for two successive periods, each one covering a maximum duration of four years. Renewals are subject to the fulfillment of past commitments, an additional work commitment and the relinquishing of 20 percent of the lands within the permit. Permit holders are entitled to a third renewal of the permit not to exceed four years if hydrocarbons are discovered and permit holders are granted an Exploitation Concession. This third renewal is subject to the fulfillment of past commitments, an additional work commitment and the relinquishing of lands such that the permit does not exceed 50 percent of the initial permit area.

The Corporation invested $5.0 million on its Tunisian asset pools during 2007 (2006 – $1.8 million) on activities related primarily to the assessment of, and equipment for, the Ras El Besh prospect as well as processing seismic data to evaluate the Salloum prospect (refer below). Capital investment during the year included $2.4 million (2006 – $nil) on the share of the restoration and purchase of the Ocean Patriot, $323,857 related to preliminary costs associated with the drilling of REB-3 (2006 – $410,283) and $683,322 (2006 – $696,193) related to the Corporation's share of administration, supervision, studies and overhead costs incurred by APEX in advancing the program at Ras El Besh. In addition, the Corporation capitalized $481,566 of its own corporate general and administrative expenses to the Tunisian asset pool during the year (2006 – $521,235). These amounts included $71,489 and $87,875 of stock based compensation expenses in each of 2007 and 2006, respectively.

(a) Ras El Besh

In December 2005, Eurogas and its operating partner applied for an exploitation concession over the Ras El Besh prospect (the "REB Exploitation Concession"). The application was accepted by the Hydrocarbon Committee of the Tunisian government in July 2006 and the concession will be officially awarded once it is gazetted in the official publication of the government decrees. For Ras El Besh, this will occur upon commencement of drilling the REB-3 well. An exploitation concession is granted for a period of 30 years with a condition that concession development work start within two years from the date of award.

To date, the partners purchased, and are upgrading an oil production platform, have tendered contracts for most equipment and services required to drill REB-3 and are moving forward with the intention of drilling REB-3 by July 2008. Failure to drill REB-3 by July 2008 could result in cancellation of the REB Exploitation Concession. Contractors may request an extension from the government to drill a multi-well program. The operator is in negotiation with drilling companies to secure a jack-up rig to drill REB-3. The REB-3 well is recognized by the Tunisian government as the commitment well under the terms of the Sfax Exploration Permit.

In preparation for oil production at Ras El Besh, Eurogas and APEX purchased an oil production platform in May 2007 for US$1.1 million (net) and plans to spend additional funds to renovate and upgrade the vessel. The total cost to purchase, upgrade and transport the production platform to Tunisia is estimated by the operator to be US$7.9 million (net to Eurogas).

A commercial discovery at Ras El Besh may result in the purchase of a floating storage tanker ("FSO") to store sales oil. The cost to purchase an FSO and tow it to Tunisia is estimated by the operator to be US$7.1 million (net to Eurogas). No such costs had been incurred as at December 31, 2007 but an estimated $2.6 million (net) may be spent in 2008, again, dependent upon the drilling and success of the REB-3 well.

Partners may drill a second well on the Ras El Besh structure at a cost of US$7.5 million (net to Eurogas) if the results of the REB-3 well are positive and may re-enter the Jawhara 1 well at a cost of US$4.0 million (net to Eurogas).

The plans for Ras El Besh drilling and potential development of the field, as described above, are subject to adequate funding being in place. A formal budget for Ras El Besh has been submitted to the ministry. The REB program will be implemented in its entirety only if the results of the REB-3 well so warrant.

**(b) Salloum**

Eurogas conducted a 60 km$^2$ 3-D shallow water seismic program in June 2007 at a cost of $864,047 (2006 – $nil) as part of its evaluation of the Salloum prospect. The prospect had flow tested 1,800 barrels of oil per day from an exploration well drilled in 1991 by a previous operator. The estimated cost of the seismic program is $2.1 million, of which Eurogas is responsible for its 45 percent share or $960,000. Processing of the seismic data is currently ongoing.

**(c) Farmout area**

In May 2006, the Corporation and its joint venture partner entered into a farmout option agreement with Anadarko Petroleum Corporation ("Anadarko"). Under the terms of the agreement, Anadarko can earn a maximum 75 percent interest in the farmout lands by completing two seismic acquisition programs, drilling two exploration wells and reimbursing the partners for $4.5 million of past costs. Three areas covering a total of 50,400 acres surrounding three structures that tested oil (Ras El Besh, Jawhara and Salloum) were excluded from the farmout agreement. During the first half of 2007, Anadarko acquired 540 km$^2$ of shallow water, 3-D seismic data over the permit area.

Unless Anadarko makes a commitment by April 1, 2008 to drill an exploration well by December 31, 2008 and thereby potentially earn a working interest in the farmout lands, the farmout option agreement will expire and all rights will revert to Eurogas and APEX. The exploration costs incurred by Anadarko (approximately $15.5 million) will become part of the cost recovery pool for Eurogas and the permit operator. As of March 17, 2008, Anadarko has not notified the partners of its intention with respect to the above mentioned option.

## CONSOLIDATED RESULTS OF OPERATIONS

### Interest and other revenue

The Corporation earns interest income on cash and short-term deposits and on the promissory notes with certain of the non-controlling unitholders of Castor LP. During the year, Eurogas earned interest revenue of $750,897 compared to $859,476 in 2006. Interest revenue decreased year-over-year as a result of reduced cash on hand due to significant expenditures during the year on oil and gas projects, offset partly by the increase in interest income on the promissory notes.

Other revenue during 2007 includes $23,551 for gas royalties from former properties and $3,500 from a sublease of office space. In 2006, other income included non-recurring proceeds of $66,000 from the sale of shares held in another company which had been written off in a prior year.

### General & administrative (G&A) expenses

Net G&A expenses for the year decreased 21 percent from $3.3 million in 2006 to $2.5 million this year.

On a gross basis, before capitalization to international asset pools as detailed below, G&A expenses totalled $4.0 million during 2007 compared with $5.0 million in 2006. This translates into a 19 percent decrease in G&A expenses. This decrease is largely attributed to non-recurring costs aggregating $1.3 million in the fourth quarter of 2006 relating to the former Chairman and Chief Executive Officer as referred to below. The residual increase is due to the development of the Castor Project and reflects the expanding activities required by the project including staffing, consulting and travel costs.

### Capitalized G&A expenses

The Corporation allocated $2.3 million in costs to its subsidiaries during 2007 compared with $2.2 million in 2006 including certain stock based compensation amounts. These costs were capitalized to respective international asset pools in association with the development phase of each location, and in accordance with service agreements. The portion allocated to subsidiaries is based on the amount of employee time and resources dedicated to each international project.

### Stock based compensation expense

Stock based compensation expense is included as a component of G&A. Stock based compensation measures the implicit cost of compensating personnel through the issuance of share options and deferred share units as further described in the Audited Consolidated Financial Statements. For the year ended December 31, 2007 the Corporation incurred stock based compensation costs of $2.1 million (2006 – $1.3 million), of which $1.3 million (2006 – $835,538) was expensed and $789,368 (2006 – $433,088) was capitalized to international asset pools, including Escal. The increase is primarily due to the issuance of 2,750,000 share options (2006 – 1,330,000) and 105,000 deferred share units (2006 – 70,000) to employees, consultants and directors during the year.

### Debt forgiveness

On December 22, 2006, the Corporation forgave all remaining amounts owing on a non-interest-bearing loan held by the Corporation's former Chairman and Chief Executive Officer totalling $800,000. All security held against the loan was released including 1,000,000 common shares of the Corporation. In addition, the Corporation accrued a bonus of $511,475 to the estate of the former Chairman and Chief Executive Officer. The amounts were recorded in G&A expenses in 2006. No such transactions occurred in 2007.

### Discontinued operations

On May 1, 2005 the Corporation sold its remaining Canadian interests in two minor, non-operated properties, which were retained for a period of time following the carve-out of assets to Great Plains, to a third party for cash proceeds of $650,000. This transaction completed the exit from Canadian oil and gas operations, with the exception of restoration obligations retained by Eurogas for any properties where petroleum and natural gas rights were relinquished prior to the 2004 carve-out of Great Plains Exploration Inc. Such restoration obligations are not significant.

As a result of the exit from Canadian oil and gas operations, revenues and expenses associated with these operations are presented as discontinued operations for financial reporting purposes for 2006. Activity in 2007 was not significant.

### Income taxes

As at December 31, 2007, the Corporation's future income tax asset was $193,127 (December 31, 2006 – $299,000) including future income tax assets of $67,729 (December 31, 2006 – $108,000) associated with the Corporation's tangible assets and foreign exploration development expense pools, and $112,523 (December 31, 2006 – $191,000) associated with share issue costs.

During the year, the Corporation recognized a provision for future income tax expense totalling $105,873 compared to $117,000 in 2006. The largest component of future income tax expense is the recognition of timing differences related to share issue costs incurred on the Corporation's October 2005 Rights Offering.

The Corporation is subject to tax on Canadian operations. A current income tax recovery on continuing operations of $64,070 was recognized during the year compared to $35,027 in 2006 (which was net of a charge of $92,000 for an expected reassessment). The 2007 tax provision has been recognized on Canadian source earnings which includes interest income on cash held and interest income charged on funds advanced to certain non-controlling unitholders of Castor LP. The current year recovery includes a partial reversal of a previous charge against earnings related to an assessment for 2002/2003 which was lower than expected.

### Net loss

Eurogas' two energy projects, namely, the Sfax Exploration Program in Tunisia and the Castor Project in Spain, are both in the development stage. The Corporation has not generated operating revenues since the exit from Canadian oil and gas operations in 2005. The Corporation incurred a net loss from continuing operations of $1.9 million before non-controlling interest of $72,456 and taxes of $41,803 compared with $2.4 million during 2006 before taxes of $81,973. The Corporation's net losses are the result of administrative and financing costs not otherwise attributed to international activities.

### Per share information

Basic earnings (loss) per common share are computed by dividing the net earnings (loss) available to common shareholders by the weighted average number of common shares outstanding during the year. For the year ended December 31, 2007, the weighted average common shares outstanding were 124,122,845 (2006 – 123,181,476). Diluted amounts per common share are calculated using the treasury stock method to determine the dilutive effect of share options. The treasury stock method assumes that the proceeds received from the exercise of "in the money" share options are used to repurchase common shares at the average market price during the period. There were no dilutive options for the years ended December 31, 2007 and 2006.

### Liquidity and capital resources

Working capital of $2.9 million as at December 31, 2007 has decreased from $17.0 million as at December 31, 2006. The Corporation funded its projects during 2007 with proceeds received from the October 2005 Rights Offering and has issued a Rights Offering Circular ("Offering") on March 14, 2008 (see below). Included in working capital at December 31, 2007 are cash and short term deposits of $1.2 million (2006 – $18.7 million) as well as $5.1 million (2006 – $nil) of cash which relates to the share issuance to ACS and is effectively restricted since it cannot be spent without approval by ACS.

Eurogas holds a revolving credit facility with Dundee Corporation ("Dundee") to a maximum of $6 million, bearing interest at the rate of prime plus 2 percent per annum, and a standby rate of 1 percent per annum on any undrawn portion of the facility. As at December 31, 2007, the full $6 million was available. Subsequent to December 31, 2007, the Corporation drew down on this facility by an aggregate of $1.5 million.

The Corporation expects to drill the Sfax commitment well, REB-3, during 2008 for approximate costs of US$9.8 million net to Eurogas. Depending upon the success of the drilling, the Tunisian program may be expanded, in which case additional funds will be required.

Based on the FEED study completed in 2007, management anticipates the cost of the Castor Project to be approximately $2 billion, which will be incurred by Escal over a period of years. According to the terms of the ACS Transaction, ACS will be responsible for the funding of the Castor Project, including providing all guarantees required, from the day it became a majority shareholder of Escal through to the inclusion of the UGS Facility into the Spanish gas system. CLP will not be required to put any equity funds or provide any warranties required by project finance lenders or provide any bridge financing. Should the Spanish authorities not grant the Development Concession within 180 days of the signing of the ACS Transaction, Eurogas will review its options and formulate plans on whether and in what manner to take the project forward.

On March 14, 2008, the Corporation issued a Rights Offering Circular for a maximum issue of 31,143,690 common shares to shareholders of record on March 27, 2008. The maximum gross proceeds of the Offering is $30,209,379 before deduction of estimated expenses of $250,000, excluding any fees or commissions which may be payable to the dealer manager of the Offering. Dundee and the directors and officers of the Corporation have indicated that they will subscribe for at least all of the common shares which they are entitled to subscribe for in accordance with their basic subscription rights. This amounts to approximate proceeds of $17.9 million.

In September 2007, in order to satisfy the Spanish authorities of Escal's financial ability to undertake the project, Dundee, the controlling shareholder of Eurogas, provided a commitment letter to Escal and the Corporation, committing to either arranging for or providing financing for the project of €45 million ($65 million) until the projected completion of project financing and for the additional estimated equity requirement of €25 million ($36 million), if then required, subject to various conditions, including the grant of the Development Concession and other permits. In the event that the Development Concession is granted within 180 days of December 20, 2007, the ACS Transaction will come into effect and the commitment letter will no longer be in effect.

At December 31, 2007, the Corporation's market value of common shares was $149.5 million based on the closing price of $1.20 per share and 124,574,763 shares outstanding. During the year, Eurogas issued 1,150,000 shares through the exercise of share options (2006 – 1,358,333). The number of common shares and share options outstanding at March 17, 2008 were 124,574,763 and 6,005,000 respectively.

### Commitments

The following table summarizes payments due for the next five years in respect of the Corporation's contractual obligations:

| **Expected Payment Schedule** ($000s) | 2008 | 2009 | 2010 | Total |
|---|---|---|---|---|
| Lease commitments | 156 | 156 | 13 | 325 |

In December 2005, the Corporation converted a Seismic Option held at Sfax to a four-year Exploration Permit with a commitment to drill one well during the four-year period in order to retain the permit.

### Related party transactions

Certain transactions with Dundee and certain of its affiliates occurred during the year including standby fee payments totalling $60,000 (2006 – $66,022) related to the Corporation's $6 million credit facility. Payments are due monthly in arrears.

Other related party transactions and balances not otherwise described in this MD&A or eliminated in the Audited Consolidated Financial Statements are as follows:

| As at and for the years ended December 31 | **2007** | 2006 |
|---|---|---|
| **EXPENSES** | | |
| Rent to an affiliate – Dundee Realty | **$ 40,290** | $ – |
| Administration and financing services to Dundee | **606,287** | – |
| **ASSETS** | | |
| Accounts receivable from Dundee | **81,255** | – |
| **LIABILITIES** | | |
| Rent payable to an affiliate – Dundee Realty | **13,430** | – |
| Accounts payable to Dundee | **634,409** | 5,096 |

## Business risks

There are a number of inherent risks associated with the Corporation's two energy projects. Many of these risks are beyond the control of management. The following outlines some of the Corporation's principal risks and their potential impact.

### Development projects

The Castor Project in Spain has not yet received all necessary governmental approvals. There can be no assurance that such approvals will be forthcoming on terms acceptable to Escal, ACS or the Corporation. The proposed Castor Project is not operational as of the date hereof and is not anticipated to be operational within the next year. The Corporation has not previously carried on business in the gas storage industry.

Should the Spanish authorities not approve the Development Concession within 180 days of December 20th, 2007, CLP will be required to purchase sufficient of the shares issued to ACS to restore its interest in Escal to 95 percent. There is no certainty that the Spanish government will approve the concession within the timeframe or at all.

In such circumstances, the Corporation will review why the Development Concession was not granted within the timeframe and will determine the courses of action available to it. This may include an extension of the ACS/Enagas Agreements or applying the proceeds of the Rights Offering to the continued development of the Castor Project. If the ACS/Enagas Agreements are not extended, the Corporation may need additional funding to complete the Castor Project which sources may include additional equity financing, debt financing or seeking a further strategic partner. If the grant of the Development Concession is ultimately refused, the Corporation will withdraw from the project subject to its obligation to abandon its initial test well drilled in the reservoir.

Development projects such as the Castor Project are subject to the successful completion of feasibility studies and the issuance of necessary government permits and regulatory approvals. In addition, when construction commences, the final amount of time required and costs involved to complete the project cannot readily be determined. The exact effect of these factors cannot be adequately predicted, but the combination of these factors may impact the economic viability of the project.

### Financing

The business and operations of the Corporation and its affiliates will require substantial additional capital. This includes the cost of drilling in Tunisia and, potentially, the costs of completing the Castor Project. There can be no assurance that the Corporation or its affiliates will continue to have access to sufficient capital, whether by debt or equity financing, to complete such projects. In addition, bank borrowings which might be made available to the Corporation are typically determined in part by the borrowing base of the Corporation. The Corporation currently has no material revenue sources and does not expect to have any until production commences from the Castor Project or the Tunisian projects, which may not occur. The Corporation will need further development of its projects to establish a borrowing base, based on proven reserves or other factors.

### International operations

The Corporation's international operations are subject to special risks inherent in doing business in a number of international locations. These risks can involve matters arising out of the policies of foreign government, imposition of special taxes or similar charges by government bodies, foreign exchange fluctuations and controls, access to capital markets, civil disturbances and deprivation or unenforceability of contract rights or the taking of property without fair compensation.

### Foreign currency

The Corporation's and its affiliates' planned capital expenditures and its participative loan are denominated in several currencies, the most important being the Euro and the U.S. dollar, while the Corporation's reporting currency is the Canadian dollar. Fluctuations in the rates of exchange may affect the ability of the Corporation to carry out its exploration and development programs. Future development costs may be higher than currently envisioned due to unforeseen events such as currency fluctuations. Currency fluctuations will also affect future profits. The Corporation does not actively hedge against foreign currency fluctuations. The Corporation's operations are subject to government legislation, policies and controls relating to prospecting, development, production, environmental protection, mining taxes and labour standards.

### Government laws and regulations

Foreign properties, operations and investments may be adversely affected by local political and economic developments, including nationalization, laws affecting foreign ownership, government participation, royalties, duties, rates of exchange, exchange controls, currency fluctuations, taxation and new laws or policies as well as bylaws and policies of Canada affecting foreign trade, investment and taxation. Furthermore, it is important that the Corporation and its affiliates maintain good relationships with the governments in certain of the countries in which they operate. The Corporation may not be able to maintain such relationships if the governments of these countries change.

### Petroleum industry

The petroleum industry is competitive in all its phases. The Corporation competes with numerous other participants in the search for the acquisition of oil and natural gas properties and in the marketing of oil and natural gas. The Corporation's competitors include oil companies which have greater financial resources, staff and facilities than those of the Corporation. The Corporation's ability to increase reserves in the future will depend not only on its ability to develop its present properties, but also on its ability to select and acquire suitable producing properties or prospects for exploratory drilling. Competitive factors in the distribution and marketing of oil and natural gas include price and methods of reliability of delivery.

The marketability of oil and natural gas acquired or discovered will be affected by numerous factors beyond the control of the Corporation. These factors include reservoir characteristics, market fluctuations, the proximity and capacity of oil and natural gas pipelines and processing equipment and government regulation. Oil and natural gas operations (exploration, production, pricing, marketing and transportation) are subject to extensive controls and regulations imposed by various levels of government, which may be amended from time to time. The Corporation's oil and natural gas operations may also be subject to compliance with federal, provincial and local laws and regulations controlling the discharge of materials into the environment or otherwise relating to the protection of the environment.

### Reserves

There are numerous uncertainties inherent in estimating quantities of reserves and cash flows to be derived therefrom, including many factors that are beyond the control of the Corporation. These evaluations include a number of assumptions relating to factors such as initial production rates, production decline rates, ultimate recovery of reserves, timing and amount of capital expenditures, marketability of production, future prices of oil and natural gas, operating costs and royalties and other government levies that may be imposed over the producing life of the reserves. Many of these assumptions are subject to change and are beyond the control of the Corporation. Actual production and cash flows derived therefrom will vary from these evaluations and such variations could be material. The Corporation does not have any reserves assigned to its properties and does not have an independent engineering evaluation report under National Instrument 51-101. The Corporation has not yet had drilling success in Tunisia on its properties. The Corporation does not currently have any oil or gas production. There can be no assurances as to the quantities of oil remaining in the Amposta reservoir.

### Access to equipment

Oil and natural gas exploration and development activities are dependent on the availability of drilling and related equipment in the particular areas where such activities will be conducted. Demand for such limited equipment or access restrictions may affect the availability of such equipment to the Corporation and may delay exploration and development activities. To the extent the Corporation is not the operator of its oil and gas properties, the Corporation will be dependent on such operators for the timing of activities related to such properties and will be largely unable to direct or control the activities of the operators.

### Impairment

The Corporation intends to use the full cost method of accounting for oil and natural gas properties. Under this accounting method, capitalized costs are reviewed for impairment to ensure that the carrying amount of these costs is recoverable based on expected future cash flows. To the extent that such capitalized costs (net of accumulated depreciation and depletion) less future taxes exceed the present value of estimated future net cash flows from the Corporation's proved oil and natural gas reserves, those excess costs would be required to be charged to operations.

### Insurance

Oil and natural gas exploration operations are subject to all the risks and hazards typically associated with such operations, including hazards such as fire, explosion, blowouts, cratering and oil spills, each of which could result in substantial damage to oil and natural gas wells, production facilities or other property and the environment, or in personal injury. In accordance with industry practice, the Corporation is not fully insured against all of these risks, nor are all such risks insurable. Although the Corporation will maintain liability insurance in an amount which it considers adequate and consistent with industry practice, the nature of these risks is such that liabilities could exceed policy limits, in which event the Corporation could incur significant costs that could have a material adverse effect upon its financial condition. Oil and natural gas production operations are also subject to all the risks typically associated with such operations, including premature decline of reservoirs and the invasion of water into producing formations.

### Director independence

Certain directors of the Corporation are also directors of other oil and gas companies and as such may, in certain circumstances, have a conflict of interest requiring them to abstain from certain decisions. Conflicts, if any, will be subject to the procedures and remedies of the Canadian Business Corporation Act.

### Key executives

The Corporation's success will depend in large measure on certain key executive personnel. The loss of the services of such key personnel could have a material adverse affect on the Corporation. The Corporation does not have key person insurance in effect for management. The contributions of these individuals to the immediate operations of the Corporation are likely to be of central importance. In addition, the competition for qualified personnel in the oil and natural gas industry is intense and there can be no assurance that the Corporation will be able to continue to attract and retain all personnel necessary for the development and operation of its business. Investors must rely upon the ability, expertise, judgment, discretion, integrity and good faith of the management of the Corporation.

## Critical accounting estimates

The preparation of the consolidated financial statements in accordance with GAAP requires management to make judgements and estimates that affect the financial results of the Corporation. Eurogas' management reviews its estimates regularly but new information and changed circumstances may result in actual results or changes to estimated amounts that differ materially from current estimates. A summary of significant accounting policies is presented in Note 1 to the Audited Consolidated Financial Statements. The critical estimates are discussed below:

Activities in Spain are in the pre-development phase. All pre-development costs relating to the Castor exploration permit in Spain are capitalized by Escal. The recovery of these costs is dependent upon the economic viability of the underground natural gas storage project and the remuneration program in place by the Spanish authorities.

The Corporation is currently in the exploratory stage of a drilling program in Tunisia and capitalizes all associated costs. The recovery of the recorded costs is contingent upon the existence of economically recoverable reserves and future profitable production.

The determination of the Corporation's income and other tax liabilities requires interpretation of complex laws and regulations, which can involve multiple Canadian and international jurisdictions. All tax filings are subject to audit and potential reassessment after the lapse of considerable time. Accordingly, the actual income tax liability may differ significantly from that estimated and recorded.

## Changes in accounting policies

On January 1, 2007, the Corporation adopted the Canadian Institute of Chartered Accountants ("CICA") Handbook Section 1530 "Comprehensive Income", Section 3251 "Equity", Section 3855 "Financial Instruments – Recognition and Measurement", Section 3861 "Financial Instruments – Disclosure and Presentation", and Section 3865 "Hedges". As required by the new standards, prior periods have not been restated.

The adoption of these standards has had no material impact on the Corporation's net earnings or cash flows. The other effects of the implementation of the new standards are discussed below.

### Comprehensive income

The new standards introduce comprehensive income, which consists of net earnings and other comprehensive income ("OCI"). Upon adoption of Section 1530, the Corporation revised its "Consolidated Statements of Operations and Retained Earnings" to include the newly required statement of comprehensive income by creating a combined statement.

The adoption of comprehensive income has been made in accordance with the applicable transitional provisions and no amounts have been reclassified to accumulated other comprehensive income. Currently, the Corporation has no OCI.

### Financial instruments

The financial instruments standard establishes the recognition and measurement criteria for financial assets, financial liabilities and derivatives. All financial instruments are required to be measured at fair value on initial recognition of the instrument, except for certain related party transactions. Measurement in subsequent periods depends on whether the financial instrument has been classified as "held-for-trading", "available-for-sale", 'held-to-maturity", "loans and receivables" or "other financial liabilities", as defined by the standard.

Financial assets and financial liabilities "held-for-trading" are measured at fair value with changes in those fair values recognized in net earnings. Financial assets "available-for-sale" are measured at fair value, with changes in those fair values recognized in OCI. Financial assets "held-to-maturity", "loans and receivables" and "other financial liabilities" are measured at amortized cost using the effective interest method of amortization. The methods used by the Corporation in determining fair value of financial instruments are unchanged as a result of implementing the new standard.

Accounts receivable, notes receivable and joint venture receivables are designated as "loans and receivables". Accounts payable and accrued liabilities are designated as "other liabilities".

The adoption of the financial instruments standard had no impact on opening retained earnings.

### Accounting changes

As of January 1, 2007, the Corporation adopted revised CICA Section 1506 "Accounting Changes", which provides expanded disclosures for changes in accounting policies, accounting estimates and corrections of errors. Under the new standard, accounting changes should be applied retrospectively unless otherwise permitted, or where impracticable to determine. As well, voluntary changes in accounting policy are made only when required by a primary source of GAAP, or when the change results in more relevant and reliable information. There is no material impact to the Corporation's consolidated financial statements as a result of implementing this new standard.

In addition, the Corporation has assessed new and revised accounting pronouncements that have been issued that are not yet effective and determined that the following may have a significant impact on the Corporation:

As of January 1, 2008, the Corporation will be required to adopt two new CICA standards, Section 3862 "Financial Instruments – Disclosures" and Section 3863 "Financial Instruments – Presentation", which will replace Section 3861 "Financial Instruments – Disclosure and Presentation". The new disclosure standard increases the emphasis on the risks associated with both recognized and unrecognized financial instruments and how those risks are managed. The new presentation standard carries forward the former presentation requirements. The new financial instruments presentation and disclosure requirements were issued in December 2006 and the Corporation is assessing the impact on its consolidated financial statements.

As of January 1, 2008, the Corporation will be required to adopt the new CICA Section 1535 "Capital Disclosures", which will require companies to disclose their objectives, policies and processes for managing capital. In addition, disclosures are to include whether companies have complied with externally imposed capital requirements. The new capital disclosure requirements were issued in December 2006 and the Corporation is assessing the impact on its consolidated financial statements.

In January 2006, the CICA Accounting Standards Board ("AcSB") adopted a strategic plan for the direction of accounting standards in Canada. As part of that plan, accounting standards in Canada for public companies are expected to converge with International Financial Reporting Standards ("IFRS") by the end of 2011. The Corporation continues to monitor and assess the impact of convergence of Canadian GAAP and IFRS.

## Control environment

### Disclosure controls and procedures

Disclosure controls and procedures have been designed to ensure that information required to be disclosed by the Corporation is accumulated and communicated to the Corporation's management, as appropriate, to allow timely decisions regarding required disclosures. The Corporation's Chief Executive Officer and Chief Financial Officer, together with management, have concluded, based on their evaluation as of the end of the period covered by the filings, that the Corporation's disclosure controls and procedures are effective to provide reasonable assurance that material information related to the issuer is made known to them by others within the Corporation.

### Internal control over financial reporting

Under the supervision of and with the participation of Eurogas' management, including the Chief Executive Officer and the Chief Financial Officer, internal control over financial reporting has been designed and maintained in order to provide reasonable assurance regarding the reliability of financial reporting, as of the end of the period covered by the filings. During the quarter ended December 31, 2007, there have been no material changes in internal control over financial reporting. In common with many small companies, segregation of duties is difficult, however, compensating controls are in place at Eurogas, including key management authorizations and reviews.

It should be noted that while the Corporation's Chief Executive Officer and Chief Financial Officer believe that the Corporation's disclosure controls and procedures provide a reasonable level of assurance that they are effective, they do not expect that the disclosure controls and procedures or internal control over financial reporting will prevent all errors and fraud. A control system, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objective of the control system is met.

## Additional information

Additional information regarding the Corporation and its business and operations is available on the Corporation's company profile at www.sedar.com. This information is also accessible on the Corporation's website at www.eurogascorp.com.

Summary Financial Information

| Three months ended | December 31, 2007 | September 30, 2007 | June 30, 2007 | March 31, 2007 |
|---|---|---|---|---|
| **Interest income** | **$ 190,363** | **$ 227,765** | **$ 181,819** | **$ 178,002** |
| **Funds provided by (used in) operations** | | | | |
| Continuing operations | **(261,901)** | **71,588** | **(171,171)** | **(153,394)** |
| Discontinued operations | **–** | **–** | **–** | **–** |
| Corporate total | **(261,901)** | **71,588** | **(171,171)** | **(153,394)** |
| **Net earnings (loss)** | | | | |
| Continuing operations | **(173,315)** | **(241,981)** | **(1,209,434)** | **(355,067)** |
| Non-controlling interest | **(121,661)** | **194,117** | **–** | **–** |
| Corporate total | **(294,976)** | **(47,864)** | **(1,209,434)** | **(355,067)** |
| Per share basic and fully diluted | **(0.00)** | **(0.00)** | **(0.01)** | **(0.00)** |
| **Capital expenditures (gross)** | **$ 8,649,462** | **$ 4,459,396** | **$ 5,832,171** | **$ 3,814,228** |

| Three months ended | December 31, 2006 | September 30, 2006 | June 30, 2006 | March 31, 2006 |
|---|---|---|---|---|
| **Sales, net of royalties** | | | | |
| Discontinued operations | $ 38,000 | $ 25,401 | $ 4,471 | $ 4,505 |
| **Interest income** | 267,491 | 222,223 | 220,171 | 215,591 |
| **Funds provided by (used in) operations** | | | | |
| Continuing operations | (151,753) | (194,974) | (288,962) | (88,466) |
| Discontinued operations | (28,728) | (6,685) | (170,546) | 2,839 |
| Corporate total | (180,481) | (201,659) | (459,508) | (85,627) |
| **Net earnings (loss)** | | | | |
| Continuing operations | (990,028) | (481,626) | (666,535) | (310,612) |
| Discontinued operations | (28,728) | (6,685) | (170,546) | 2,839 |
| Corporate total | (1,018,756) | (488,311) | (837,081) | (307,773) |
| Per share basic and fully diluted | (0.01) | (0.00) | (0.01) | (0.00) |
| **Capital expenditures (gross)** | $ 1,351,721 | $ 3,027,430 | $ 2,523,231 | $ 1,501,677 |

## CONSOLIDATED RESULTS OF OPERATIONS – FOURTH QUARTER ANALYSIS

Interest income decreased 62 percent during the quarter to $190,363 from $267,491 during the fourth quarter of 2006. The decrease is a result of a lower average cash balance on hand during the quarter compared to last year partly offset by increased interest on the notes receivable. In the fourth quarter of 2006, the Corporation recognized a non-recurring gain on the sale of shares of $66,000.

G&A expenses for the quarter totalled $708,421 in comparison to $1.6 million during the fourth quarter of 2006. The decrease is due to non-recurring charges of $1.3 million in the fourth quarter of 2006 related to the forgiveness of a share purchase loan issued to the Corporation's former Chairman and CEO and the accrual of a bonus to his estate. Excluding these charges, G&A costs increased by approximately $0.4 million during the quarter compared to the fourth quarter of 2006 due to certain non-recurring staff costs including severance payments as well as charges for corporate services from Dundee, legal and audit fees and higher stock based compensation charges.

The Corporation capitalized $548,276 of G&A expenses during the fourth quarter to international projects which included $150,635 of stock based compensation. This is a 26 percent decrease over the fourth quarter of 2006 where $745,922 of G&A was capitalized, including $93,622 of stock based compensation. The decrease is related to increases in non-capitalizable costs such as legal and audit fees which are not recharged to the projects and lower total costs in 2007.

During the fourth quarter of 2007, the Corporation recognized an income tax provision of $15,099, representing a provision of $76,832 for future income taxes and a recovery of $61,733 for current income taxes. The Corporation recorded a $228,045 current tax recovery during the fourth quarter of 2006. The recovery in 2006 was partially driven by the non-recurring charge of $1.3 million associated with debt forgiveness booked during the quarter.

The net loss from continuing operations decreased significantly to $173,315 before non-controlling interest from $990,028 during the fourth quarter of 2006; after non-controlling interest, the net loss decreased by $695,052 to $294,976. The decreases are driven primarily by the non-recurring charges in 2006 related to the former Chairman and Chief Executive Officer as described above. The results from discontinued operations during 2007 were not significant and accordingly are no longer disclosed separately.

The Corporation's capital expenditures were $8.6 million compared with $1.4 million during the fourth quarter of 2006. This includes $1.0 million expenditure in Tunisia and $7.6 million in Spain, primarily on the FEED Study and EPC studies. During the same quarter of 2006, Eurogas invested an aggregate of $1.4 million in Spain and Tunisia. The Corporation, through Escal, continued to advance its EPC studies in preparation for the Castor Project. In Tunisia, preparations continued for the drilling of REB-3, including refurbishment of the production jack-up rig.

# Management's Responsibility for Financial Statements

The accompanying consolidated financial statements, the notes thereto and other financial information contained in this annual report have been prepared by, and are the responsibility of, the management of Eurogas Corporation. These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles, using management's best estimates and judgments when appropriate.

The Board of Directors is responsible for ensuring that management fulfills its responsibility for financial reporting and internal control. The Audit Committee, which is comprised of directors, none of whom are employees of the Corporation, meets with management as well as the external auditors to satisfy itself that management is properly discharging its financial reporting responsibilities and to review its consolidated financial statements and the report of the auditors. It reports its findings to the Board of Directors, which approves the consolidated financial statements.

The consolidated financial statements have been audited by Ernst & Young LLP, the independent auditors, in accordance with Canadian generally accepted auditing standards. The auditors have full and unrestricted access to the Audit Committee.

**M. Jaffar Khan**
President and Chief Executive Officer
March 17, 2008

**Andrew Constantinidis**
Vice President and Chief Financial Officer

# Auditors' Report to Shareholders

**To the Shareholders of Eurogas Corporation**

We have audited the consolidated balance sheets of Eurogas Corporation as at December 31, 2007 and 2006 and the consolidated statements of operations and comprehensive loss, changes in shareholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Corporation as at December 31, 2007 and 2006 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Ernst + Young LLP

Calgary, Canada
March 17, 2008

**Ernst & Young LLP**
Chartered Accountants

# Consolidated Balance Sheets

| As at December 31 | 2007 | 2006 |
|---|---|---|
| **ASSETS** | | |
| **Current** | | |
| Cash and short-term deposits | **$ 1,180,753** | $ 18,738,542 |
| Restricted cash (Note 7) | **5,124,936** | – |
| Accounts receivable | **206,306** | 198,464 |
| Prepaids and other (Note 3) | **2,155,871** | 646,209 |
| Notes receivable (Note 4) | **7,639,629** | – |
| Joint venture receivable | **–** | 463,382 |
| Taxes recoverable | **196,957** | – |
| | **16,504,452** | 20,046,597 |
| Notes receivable (Note 4) | **1,222,059** | 1,166,706 |
| Property, plant and equipment (Note 5) | **80,428,862** | 57,701,955 |
| Future income taxes (Note 14) | **193,127** | 299,000 |
| | **$ 98,348,500** | $ 79,214,258 |
| **LIABILITIES** | | |
| **Current** | | |
| Accounts payable and accrued liabilities (Notes 6 and 11) | **$ 8,468,930** | $ 2,948,845 |
| Advance from ACS (Note 7) | **5,124,936** | – |
| Taxes payable | **–** | 53,005 |
| | **13,593,866** | 3,001,850 |
| Asset retirement obligation (Note 8) | **617,688** | 432,762 |
| Non-controlling interest (Note 9) | **11,981,554** | 3,946,704 |
| | **26,193,108** | 7,381,316 |
| Commitments and contingencies (Notes 2, 5 and 14) | | |
| **SHAREHOLDERS' EQUITY** | | |
| Share capital (Note 13) | **67,898,790** | 67,719,390 |
| Contributed surplus (Note 13) | **4,117,269** | 2,066,878 |
| Retained earnings | **139,333** | 2,046,674 |
| | **72,155,392** | 71,832,942 |
| | **$ 98,348,500** | $ 79,214,258 |

*The accompanying notes are an integral part of these consolidated financial statements*

On behalf of the Board,

Derek H. L. Buntain

**Derek H.L. Buntain**
Director

**Garth A.C. MacRae**
Director

# Consolidated Statements of Operations and Comprehensive Loss

| For the years ended December 31 | 2007 | 2006 |
|---|---|---|
| **REVENUE** | | |
| Interest and other | $ 777,949 | $ 925,476 |
| **EXPENSES** | | |
| General and administrative (Note 11) | 2,557,920 | 3,254,175 |
| Interest (Note 11) | 60,000 | 66,021 |
| Depreciation and accretion | 52,476 | 33,978 |
| Foreign exchange loss (gain) | 45,547 | (61,870) |
| | 2,715,943 | 3,292,304 |
| **LOSS FROM CONTINUING OPERATIONS BEFORE INCOME TAXES** | (1,937,994) | (2,366,828) |
| **PROVISION FOR INCOME TAXES** (Note 14) | 41,803 | 81,973 |
| **LOSS FROM CONTINUING OPERATIONS** | (1,979,797) | (2,448,801) |
| Non-controlling interest (Note 9) | 72,456 | – |
| **LOSS FROM DISCONTINUED OPERATIONS, NET OF TAX** (Note 12) | – | (203,120) |
| **NET LOSS AND COMPREHENSIVE LOSS FOR THE YEAR** | $ (1,907,341) | $ (2,651,921) |
| **LOSS PER COMMON SHARE BASIC AND DILUTED** (Note 13) | | |
| Loss from continuing operations | $ (0.02) | $ (0.02) |
| Earnings (loss) from discontinued operations, net of tax (Note 12) | – | – |
| Net loss | (0.02) | (0.02) |

*The accompanying notes are an integral part of these consolidated financial statements*

# Consolidated Statements of Changes in Shareholders' Equity

| As at and for the years ended December 31, 2007 and 2006 | Common Shares | Contributed Surplus | Retained Earnings | Total |
|---|---|---|---|---|
| Balance, December 31, 2005 | $ 66,599,048 | $ 817,696 | $ 4,698,595 | $ 72,115,339 |
| Net loss | – | – | (2,651,921) | (2,651,921) |
| Stock based compensation | – | 1,268,626 | – | 1,268,626 |
| Share issue costs | (22,035) | – | – | (22,035) |
| Forgiveness of share purchase loan | 800,000 | – | – | 800,000 |
| Exercise of options | 342,377 | (19,444) | – | 322,933 |
| Balance, December 31, 2006 | 67,719,390 | 2,066,878 | 2,046,674 | 71,832,942 |
| Net loss | – | – | (1,907,341) | (1,907,341) |
| Stock based compensation | – | 2,050,391 | – | 2,050,391 |
| Exercise of options | 179,400 | – | – | 179,400 |
| **Balance, December 31, 2007** | **$ 67,898,790** | **$ 4,117,269** | **$ 139,333** | **$ 72,155,392** |

*The accompanying notes are an integral part of these consolidated financial statements*

# Consolidated Statements of Cash Flows

| For the years ended December 31 | 2007 | 2006 |
|---|---|---|
| **OPERATING ACTIVITIES** | | |
| Loss from continuing operations | **$ (1,907,341)** | $ (2,448,801) |
| Depreciation and accretion | **52,476** | 33,978 |
| Provision for future income taxes (Note 14) | **105,873** | 117,000 |
| Stock based compensation expense (Notes 5, 11 and 13) | **1,261,023** | 1,635,538 |
| Unrealized foreign exchange loss (gain) | **45,547** | (61,870) |
| Non-controlling interest | **(72,456)** | – |
| | **(514,878)** | (724,155) |
| Cash used in discontinued operations | **–** | (203,120) |
| Change in non-cash working capital (Note 15) | **3,359,960** | (603,427) |
| Cash provided by (used in) operating activities | **2,845,082** | (1,530,702) |
| **FINANCING ACTIVITIES** | | |
| Proceeds on issuance of partnership units (Note 5) | **430,002** | 908,714 |
| Proceeds on issuance of shares in subsidiary (Note 9) | **139,445** | – |
| Advance from ACS (Note 7) | **5,124,936** | – |
| Proceeds on exercise of stock options (Note 13) | **179,400** | 322,933 |
| Rights offering costs (Note 13) | **–** | (22,035) |
| Credit facility (Note 11) | **–** | (100,000) |
| Notes receivable (Notes 4 and 15) | **(331,338)** | (55,353) |
| Cash provided by financing activities | **5,542,445** | 1,054,259 |
| **INVESTING ACTIVITIES** | | |
| Investment in property, plant and equipment (Note 5) | **(21,630,874)** | (7,970,971) |
| Change in restricted cash (Note 7) | **(5,124,936)** | – |
| Change in non-cash working capital (Note 15) | **856,041** | 950,363 |
| Cash used in investing activities | **(25,899,769)** | (7,020,608) |
| Unrealized foreign exchange gain (loss) | **(45,547)** | 61,870 |
| **DECREASE IN CASH AND SHORT-TERM DEPOSITS** | **(17,557,789)** | (7,435,181) |
| **CASH AND SHORT-TERM DEPOSITS, BEGINNING OF YEAR** | **18,738,542** | 26,173,723 |
| **CASH AND SHORT-TERM DEPOSITS, END OF YEAR** | **$ 1,180,753** | $ 18,738,542 |

*The accompanying notes are an integral part of these consolidated financial statements*

# Notes to the Consolidated Financial Statements

Years ended December 31, 2007 and 2006

## 1. SIGNIFICANT ACCOUNTING POLICIES

Eurogas Corporation ("Eurogas" or the "Corporation") is an oil and natural gas company with a mandate to create long-term value through the development of high impact energy projects, including a major underground natural gas storage facility in Spain, and oil and natural gas exploration in Tunisia. These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") and reflect the following policies:

### Basis of presentation

The consolidated financial statements include the accounts of the Corporation and all of its subsidiaries including Eurogas International Inc., Castor GP Ltd., Castor UGS Limited Partnership ("CLP"), Escal UGS S.L. ("Escal"), Amposta Energy Europe AB and Amposta Resources S.L.

### Foreign currency translation

The Corporation follows the temporal method in accounting for foreign currency translation of its integrated foreign operations and translates its foreign-denominated monetary assets and liabilities at the exchange rate prevailing at year-end. Non-monetary assets and liabilities are translated at historic rates. Revenues and expenses are translated at the average rate of exchange for the year. Exchange gains or losses are included in the statements of operations. The Corporation's functional currency is the Canadian dollar and the financial statements are prepared in Canadian dollars.

### Financial instruments

The Corporation's financial instruments consist of cash and short-term deposits, restricted cash, accounts receivable, joint venture receivable, notes receivable, prepaids and other, taxes recoverable, accounts payable and advance from non-controlling shareholder. At December 31, 2007 and 2006 the fair value of financial instruments approximated book value due to the near-term maturity or the associated interest rate terms.

### Exploration and development expenditures

The Corporation intends to follow the full-cost method of accounting for exploration and development expenditures whereby all costs related to the exploration for and development of oil and natural gas reserves, including asset retirement costs, are accumulated in separate country-by-country cost centres. Costs include lease acquisition, geological and geophysical expenditures, carrying costs of non-productive properties, the drilling of productive and non-productive wells and related plant and production equipment costs, and that portion of general and administrative expenses and interest directly attributable to exploration and development activities. Proceeds received from the disposal of properties are normally deducted from the full-cost pool without recognition of a gain or loss. When such a disposal would alter the depletion and depreciation rate by more than 20 percent, a gain or loss would be recognized.

### Pre-development costs

Escal is currently developing a major underground natural gas storage facility in Spain and capitalizes all costs associated with this project. The project entails the conversion of the abandoned Amposta oilfield to a major natural gas storage facility. The recovery of its recorded costs is contingent upon either the completion of the ACS Transaction (see Note 2) or upon future profitability of the project which entails the receipt of necessary governmental approvals in Spain (see Note 2), and the financing and construction of associated facilities for the natural gas storage facility.

In Tunisia, the Corporation is currently in the exploratory stage of its drilling programs and capitalizes all costs associated with the program. The recovery of recorded costs is contingent upon the existence of economically recoverable reserves and future profitable production.

### Impairment

The Corporation evaluates its oil and natural gas assets in each reporting period to determine that the costs are recoverable and do not exceed the fair value of the properties. If the carrying value of the oil and natural gas assets is not assessed to be recoverable, an impairment loss is recognized.

### Joint venture activity

Substantially all of the Corporation's exploration, development and production activities are conducted jointly with other entities and, accordingly, the consolidated financial statements reflect only the Corporation's proportionate interest in such activities, unless activity is conducted through a controlled subsidiary, in which case the subsidiary is consolidated with that portion held by others reflected as non-controlling interest.

### Revenue recognition

Oil and natural gas sales are recognized when title passes to an external party. Interest income is reported as it is earned.

### Depletion and depreciation

Depletion of oil and natural gas properties and equipment is computed using the unit-of-production method where the ratio of production to proved reserves, before royalties, determines the proportion of depletable costs to be expensed. Undeveloped properties are excluded from the depletion calculation until quantities of proved reserves are found or impairment occurs. Volumes are converted to equivalent units using the ratio of 1 barrel of oil to 6 mcf (thousand cubic feet) of natural gas. Depreciation of office equipment and computer equipment is provided for on a 10 percent and 35 percent declining balance basis, respectively.

### Asset retirement obligation

The Corporation recognizes the fair value of legal obligations associated with the retirement and reclamation of tangible long-lived assets when the obligation is incurred, with a corresponding increase to the carrying amount of the related assets. This corresponding increase to capitalized costs is amortized to earnings on a basis consistent with depreciation, depletion and amortization of the underlying assets. Subsequent changes in the estimated fair value of the asset retirement obligation are capitalized and amortized over the remaining useful life of the underlying asset. The asset retirement obligation liabilities are carried on the consolidated balance sheet at their discounted present value and are accreted over time for the change in their present value.

### Measurement uncertainty

Asset retirement obligation, depletion, impairment and ceiling test calculations are based on estimates of oil and natural gas volumes and prices, future costs and other relevant assumptions. Accruals for revenue and expenses are prepared based on estimates when actual amounts are not yet known. By their nature, these estimates are subject to measurement uncertainty and the effect on the consolidated financial statements of changes in such estimates in future years could be significant.

### Stock based compensation

The Corporation recognizes stock based compensation expense using the fair value method when share options with no cash settlement features are granted to employees and directors under the fixed share option plan. Under this method, compensation expense is measured at the grant date and recognized as a charge to earnings over the vesting period with a corresponding credit to contributed surplus. The fair value of the options is determined using the Black-Scholes option pricing model. Upon the exercise of the options, consideration paid by employees or directors together with the amount previously recognized in contributed surplus is recorded as an increase to share capital. During 2007, all of the remaining options issued under the accounting rules in place before January 1, 2003 were exercised; accordingly, no amounts had been recognized in contributed surplus for these share options.

### Income taxes

All international projects are in the pre-development stage and capitalized costs to date will be available for deduction for income tax purposes in their respective jurisdictions once commercial operations commence.

The Corporation follows the liability method of accounting for income taxes. Under this method, future tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities, and measured using the substantively enacted tax rates and laws that will be in effect when the differences are expected to reverse. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the period in which the change is substantively enacted. The future income tax assets are evaluated and, if realization is not considered to be more likely than not, a valuation allowance is recorded.

### Cash and short-term deposits

Cash and short-term deposits consist of cash and short-term deposits with a maturity of less than 90 days.

### Per share information

Basic earnings (loss) per common share are computed by dividing the net earnings (loss) attributable to common shareholders by the weighted average number of common shares outstanding during the period. Diluted earnings per common share are calculated using the treasury stock method to determine the dilutive effect of stock options. The treasury stock method assumes that the proceeds received from the exercise of "in-the-money" stock options are used to repurchase common shares at the average market price during the period.

## Changes in accounting policies

On January 1, 2007, the Corporation adopted the Canadian Institute of Chartered Accountants ("CICA") Handbook Section 1530 "Comprehensive Income", Section 3251 "Equity", Section 3855 "Financial Instruments – Recognition and Measurement", Section 3861 "Financial Instruments – Disclosure and Presentation", and Section 3865 "Hedges". As required by the new standards, prior periods have not been restated.

The adoption of these standards has had no material impact on the Corporation's net earnings or cash flows. The other effects of the implementation of the new standards are discussed below.

### Comprehensive income

The new standards introduce comprehensive income, which consists of net earnings and other comprehensive income ("OCI"). Upon adoption of Section 1530, the Corporation revised its "Consolidated Statements of Operations and Retained Earnings" to include the newly required statement of comprehensive income by creating a combined statement.

The adoption of comprehensive income has been made in accordance with the applicable transitional provisions and no amounts have been reclassified to accumulated other comprehensive income. Currently, the Corporation has no OCI.

### Financial instruments

The financial instruments standard establishes the recognition and measurement criteria for financial assets, financial liabilities and derivatives. All financial instruments are required to be measured at fair value on initial recognition of the instrument, except for certain related party transactions. Measurement in subsequent periods depends on whether the financial instrument has been classified as "held-for-trading", "available-for-sale", 'held-to-maturity", "loans and receivables" or "other financial liabilities", as defined by the standard.

Financial assets and financial liabilities "held-for-trading" are measured at fair value with changes in those fair values recognized in net earnings. Financial assets "available-for-sale" are measured at fair value, with changes in those fair values recognized in OCI. Financial assets "held-to-maturity", "loans and receivables" and "other financial liabilities" are measured at amortized cost using the effective interest method of amortization. The methods used by the Corporation in determining fair value of financial instruments are unchanged as a result of implementing the new standard.

Accounts receivable, notes receivable, prepaids and other, taxes recoverable and joint venture receivables are designated as "loans and receivables". Accounts payable and accrued liabilities and advance from non-controlling shareholder are designated as "other liabilities".

The adoption of the financial instruments standard had no impact on opening retained earnings.

### Accounting changes

As of January 1, 2007, the Corporation adopted revised CICA Section 1506 "Accounting Changes", which provides expanded disclosures for changes in accounting policies, accounting estimates and corrections of errors. Under the new standard, accounting changes should be applied retrospectively unless otherwise permitted, or where impracticable to determine. As well, voluntary changes in accounting policy are made only when required by a primary source of GAAP, or when the change results in more relevant and reliable information. There is no material impact to the Corporation's consolidated financial statements as a result of implementing this new standard.

In addition, the Corporation has assessed new and revised accounting pronouncements that have been issued that are not yet effective and determined that the following may have a significant impact on the Corporation:

As of January 1, 2008, the Corporation will be required to adopt two new CICA standards, Section 3862 "Financial Instruments – Disclosures" and Section 3863 "Financial Instruments – Presentation", which will replace Section 3861 "Financial Instruments – Disclosure and Presentation". The new disclosure standard increases the emphasis on the risks associated with both recognized and unrecognized financial instruments and how those risks are managed. The new presentation standard carries forward the former presentation requirements. The new financial instruments presentation and disclosure requirements were issued in December 2006 and the Corporation is assessing the impact on its consolidated financial statements.

As of January 1, 2008, the Corporation will be required to adopt the new CICA Section 1535 "Capital Disclosures", which will require companies to disclose their objectives, policies and processes for managing capital. In addition, disclosures are to include whether companies have complied with externally imposed capital requirements. The new capital disclosure requirements were issued in December 2006 and the Corporation is assessing the impact on its consolidated financial statements.

In January 2006, the CICA Accounting Standards Board adopted a strategic plan for the direction of accounting standards in Canada. As part of that plan, accounting standards in Canada for public companies are expected to converge with International Financial Reporting Standards ("IFRS") by the end of 2011. The Corporation continues to monitor and assess the impact of convergence of Canadian GAAP and IFRS.

## 2. DISPOSAL OF INTEREST IN SUBSIDIARY

As at December 20, 2007, the Corporation (through CLP) entered into agreements with ACS Servicios Comunicaciones y Energia, S.L. ("ACS") and Enagas, S.A. ("Enagas") herein referred to as the "ACS Transaction". Under the ACS Transaction, Escal issued shares such that ACS increased its ownership in Escal from 5 percent (acquired in August 2007 pursuant to a Collaboration Agreement entered into in December 2006) to 66.67 percent, and thereby reducing the interest of CLP, of which the Corporation is a 73.7 percent owner, to 33.33 percent from 95 percent.

The ACS Transaction requires that, in the event that the Development Concession for the Castor Project is not granted within 180 days of the execution of the ACS Transaction, CLP will purchase and ACS will sell, at nominal value, a number of shares of Escal such that ACS will have 5 percent ownership and CLP will have 95 percent and the agreements will terminate. There is no assurance that the Development Concession will be granted within such timeframe, or at all.

In accordance with GAAP for such a transaction, the Corporation is deemed to have retained control of Escal until the Spanish authorities approve the Development Concession, even though the issuance of the new treasury shares to ACS has been legally registered in Spain. Accordingly, the Corporation has continued to consolidate the results and balances of Escal in its financial statements.

Upon the grant of the Development Concession within the timeframe and, therefore, fulfillment of the condition referred to above, the Corporation will record an equity investment in Escal whereby the investment will be initially recorded at the carrying value of CLP's proportionate interest in Escal at that date. This will be adjusted by CLP's proportionate share of earnings, losses and other comprehensive income or loss of Escal thereafter.

Until inclusion in the Spanish gas system, the board of Escal will have nine directors allocated as follows: ACS – six; CLP – two and Enagas – one. After completion and inclusion in the gas system, each party will be allocated seats on a proportionate basis to its ownership in Escal.

ACS has agreed that, within 25 days of the grant of the Development Concession, it will repay to CLP most of the amount of its prior investment in the Castor Project. The amount is subject to due diligence which is presently underway and is expected to be approximately €30 million ($43.7 million). This would be applied by CLP to the loan to Escal (presently eliminated upon consolidation) and its original equity investment in Escal. Amounts attributable to non-controlling unitholders of CLP will be applied against the notes receivable and accrued interest due to Eurogas, and as a result, Eurogas is expected to net approximately $40 million. A portion of the aggregate funds may have to be repaid to ACS if the regulatory authorities do not include certain costs in the remuneration base.

Upon the unconditional change of control pursuant to the grant of the Development Concession, Escal will be considered to be a self-sustaining operation and, in determining the carrying value of the equity investment in Escal, the current method will be used for translating the results of its operations with unrealized foreign currency translation adjustments being included in accumulated other comprehensive income.

In the event that regulatory approval is not obtained within 180 days and CLP's interest reverts back to 95 percent, the Corporation will need to assess whether it has experienced an impairment in its property, plant and equipment.

The ACS Transaction also provides that, no later than the inclusion of the Castor Project in the remuneration regime of the Spanish gas system, ACS will sell and Enagas will buy 50 percent of the ACS interest in Escal under a pre-established pricing formula. As a result, CLP, ACS and Enagas will each own a one-third interest in Escal.

Furthermore, under the terms of the ACS Transaction, for a period of 180 days after the start up of the UGS Facility, CLP may sell part or all of its Escal shares to ACS and Enagas for proceeds on the same basis as the ACS sale to Enagas (a "tag along right"). CLP also has a tag along right should ACS decide to sell a certain portion of their Escal shares other than to Enagas as referred to above.

## 3. PREPAIDS AND OTHER

As at December 31, 2007, Escal had Value Added Tax ("VAT") amounts receivable from Spanish Authorities totalling $1.8 million related to expenditures in Spain (2006 – $279,590). VAT is refunded annually.

## 4. NOTES RECEIVABLE

| As at December 31 | 2007 | 2006 |
|---|---|---|
| Notes due within one year | **$ 7,363,644** | $ – |
| Accrued interest | **275,985** | – |
| | **7,639,629** | – |
| Notes due August 1, 2012 | **922,547** | 922,547 |
| Accrued interest | **299,512** | 244,159 |
| | **1,222,059** | 1,166,706 |
| | **$ 8,861,688** | $ 1,166,706 |

Pursuant to a meeting of the CLP held on May 17, 2007, the partners agreed to a $28 million cash call. The Corporation funded the non-controlling unitholders' portion of the cash call totalling $7,363,644 by way of demand secured promissory notes receivable with an interest rate of six percent per annum and a term of the earlier of: May 17, 2008; the closing date of a sale by the Borrower of its interest in CLP; 240 days from the date that Escal receives its Development Concession; the date the Castor Project is abandoned; and the date the CLP is dissolved.

During 2002, the Corporation advanced funds aggregating $922,547 to certain unitholders of CLP. The notes bear interest at six percent per annum and are repayable by August 1, 2012.

The notes are secured by a pledge of each of the respective partners' interests in CLP. Interest income of $331,338 (2006 -- $55,353) was recorded during the year.

The fair value of the notes approximates the carrying value as reported on the consolidated balance sheet.

## 5. PROPERTY, PLANT AND EQUIPMENT

| As at December 31 | **2007** | 2006 |
|---|---|---|
| Oil and natural gas properties: | | |
| Spain | **$ 54,753,345** | $ 36,938,661 |
| Tunisia | **25,548,113** | 20,594,525 |
| | **80,301,458** | 57,533,186 |
| Other: | | |
| Office equipment, furniture and fixtures | **831,366** | 844,381 |
| Accumulated depreciation | **(703,962)** | (675,612) |
| | **$ 80,428,862** | $ 57,701,955 |

Net capital investment during the year by cost centre was as follows:

| For the years ended December 31 | **2007** | 2006 |
|---|---|---|
| Oil and natural gas properties: | | |
| Spain | **$ 17,814,684** | $ 6,494,485 |
| Tunisia | **4,953,588** | 1,792,714 |
| | **22,768,272** | 8,287,199 |
| Other: | | |
| Office equipment, furniture and fixtures | **(13,015)** | 116,860 |
| | **$ 22,755,257** | $ 8,404,059 |

Oil and natural gas properties include non-cash amounts totalling $789,368 (2006 – $433,088) related to stock based compensation charges capitalized during the year.

### a) Spain

The Corporation holds an interest in the Castor Exploration Permit through CLP, which was formed in 2001. The Castor Exploration Permit covers the abandoned Amposta oilfield, on which Escal is developing an underground gas storage facility, the Castor Project.

Escal owns the Castor Exploration Permit. As described in Note 2, the Corporation will continue to consolidate the results of Escal until the change of control of Escal is unconditional. Upon effective change of control, the Corporation will own a 24.6 percent interest in the Castor Project. As at December 31, 2006, the Corporation's effective interest in the Castor Project was 73.0 percent.

The components of capital expenditures on Spanish oil and gas properties for each of the years 2007 and 2006 are as follows:

| For the years ended December 31 | 2007 | 2006 |
|---|---|---|
| Assistance contract and FEED study | **$ 8,273,650** | $ 1,422,264 |
| Engineering, procurement and construction studies | **2,616,966** | – |
| Geotechnical and other technical studies | **2,365,811** | 1,840,424 |
| Financing advice | **917,139** | – |
| Oil related studies | **–** | 481,321 |
| Escal general and administrative expenses | **2,011,214** | 1,051,659 |
| Corporate general and administrative expenditures | **912,025** | 1,353,603 |
| Capitalized stock based compensation | **717,879** | 345,214 |
| | **$ 17,814,684** | $ 6,494,485 |

All administrative costs related to the Castor Project have been capitalized as part of the project's pre-development phase of operations. Capitalized amounts include general and administrative expenditures incurred by the Corporation and Escal, consistent with prior years, and in accordance with service agreements.

Eurogas increased its interest from 73.0 percent to 73.7 percent in CLP in January 2007 following the completion of a cash call in which certain non-controlling unitholders chose not to participate. An additional cash call was agreed to by all partners in May 2007 aggregating $28 million. The Corporation funded the non-controlling unitholders' portion of the cash call by way of promissory notes (Note 4). A total of $430,002 (2006 – $908,714) was received from non-controlling unitholders during the year from cash calls.

As at December 31, 2006, capital expenditures attributed to non-controlling unitholders of CLP, but not yet recovered by the Corporation, totalled $463,382; there were no such amounts attributed as at December 31, 2007.

### b) Tunisia

#### Sfax Permit

Eurogas holds a 45 percent interest in the 1.0 million acre Sfax permit, located offshore in the Gulf of Gabes, where the Corporation is a non-operating partner in the permit conducting exploration programs for oil and natural gas. The Corporation's operating partner in the permit is Atlas Petroleum Exploration Worldwide Ltd. ("APEX"). Under the terms of the joint operating agreement, the Corporation shares in 45 percent of the expenditures of the permit. The Corporation's 2007 program included spending on its share of the development of the Ras El Besh ("REB-3") prospect as well as processing seismic data to evaluate the Salloum prospect. Aggregate capital expenditures amounted to $5.0 million (2006 – $1.8 million) during the year.

The following table shows the components of capital expenditures on Tunisian oil and gas properties for each of the years 2007 and 2006:

| For the years ended December 31 | 2007 | 2006 |
|---|---|---|
| Share of restoration and purchase of Ocean Patriot | $ 2,392,329 | $ – |
| Share of permit operator costs | 683,322 | 696,193 |
| Seismic activities | 970,517 | 79,356 |
| Ras El Besh well expenditures | 323,857 | 410,283 |
| Corporate general and administrative expenditures | 410,077 | 433,360 |
| Capitalized stock based compensation | 71,489 | 87,875 |
| Other expenditures | 101,997 | 85,647 |
| | $ 4,953,588 | $ 1,792,714 |

In December 2005, Eurogas and its operating partner applied for an exploitation concession over the Ras El Besh prospect (the "REB Exploitation Concession"). The application was accepted by the Hydrocarbon Committee of the Tunisian government in July 2006 and the concession will be officially awarded once it is gazetted in the official publication of the government decrees. For Ras El Besh, this will occur upon commencement of drilling the REB-3 well. Under the terms of the REB Exploitation Concession, failure to drill a well could result in cancellation of the REB Exploitation Concession. The operator is in negotiation with drilling companies to secure a jack-up rig to drill REB-3. Accordingly, during the year, Eurogas spent $2.4 million on its share of restoration and purchase costs of the Ocean Patriot, a production unit (2006 – $nil) in preparation for the planned drilling of the REB-3 well.

The Corporation continues to capitalize G&A expenditures to Tunisian asset pools as part of the pre-development phase of operations as well as to capitalize stock based compensation costs. Corporate costs are capitalized to international asset pools in accordance with service agreements.

Eurogas conducted a 60 km$^2$ 3-D shallow water seismic program in June 2007 at a cost of $864,047 (2006 – $nil) as part of its evaluation of the Salloum prospect. The estimated cost of the seismic program is $2.1 million, of which Eurogas is responsible for its 45 percent share or $960,000. Processing of the seismic data is currently ongoing.

During May 2006, the Corporation and its joint venture partner entered into a farmout option agreement with Anadarko Petroleum Corporation ("Anadarko"). Under the terms of the agreement, Anadarko can earn a maximum 75 percent interest in the farmout lands by completing two seismic acquisition programs, drilling two exploration wells and reimbursing the partners for $4.5 million of past costs. Three areas covering a total of 50,400 acres surrounding three structures that tested oil (Ras El Besh, Jawhara and Salloum) were excluded from the farmout agreement. During the first half of 2007, Anadarko acquired 540 $km^2$ of shallow water 3-D seismic data over the permit area.

Unless Anadarko makes a commitment by April 1, 2008 to drill an exploration well by December 31, 2008 and thereby potentially earn a working interest in the farmout lands, the farmout option agreement will expire and all rights will revert to Eurogas and APEX. The exploration costs incurred by Anadarko (approximately $15.5 million) will become part of the cost recovery pool for Eurogas and the permit operator. As of March 17, 2008, Anadarko has not notified the partners of its intention with respect to the above mentioned option.

## 6. CONTRACT FEE PAYABLE

On October 19, 2006, Escal entered into an Assistance Contract with ACS for the development of the Castor Project. Under the terms of this contract, ACS were contracted to undertake the Front End Engineering and Design study ("FEED") and provide permitting and licensing services.

In association with the Assistance Contract, the Corporation accrued $1,122,500 for the period from October 19 to December 31, 2006.

As at December 31, 2007, Escal had recorded accounts payable and accruals aggregating $6.6 million.

## 7. ADVANCE FROM ACS

On December 20, 2007, pursuant to the ACS Transaction, Escal issued shares to ACS for cash proceeds of $5,124,936. The cash advance is effectively restricted since it can only be spent on the approval of ACS. Accordingly, the cash received for the shares is included in restricted cash on the consolidated balance sheet.

## 8. ASSET RETIREMENT OBLIGATION

The Corporation estimates its total future asset retirement obligation ("ARO") based on its ownership in all wells, the estimated costs to abandon and reclaim such wells and the estimated timing of the costs to be incurred in future periods.

As at December 31, 2007, the Corporation had obligations, through its controlling interest in Escal, in one well, Castor-1, which was drilled during 2005. To calculate the fair value of the ARO, the Corporation's estimates include total undiscounted cash flows required to settle the ARO of approximately $2.3 million, a time horizon of 35 years, a credit-adjusted risk-free rate of 7 percent and an inflation rate of 2 percent.

| As at and for the years ended December 31 | | 2007 | | 2006 |
|---|---|---|---|---|
| Balance, beginning of year | $ | **432,762** | $ | 423,940 |
| Change in estimate | | **160,800** | | – |
| Accretion expense | | **24,126** | | 8,822 |
| Balance, end of year | $ | **617,688** | $ | 432,762 |

## 9. NON-CONTROLLING INTEREST

The following table shows the components of non-controlling interest:

| As at and for the years ended December 31 | | 2007 | | 2006 |
|---|---|---|---|---|
| Balance, beginning of year | $ | **3,946,704** | $ | 3,037,990 |
| Cash calls in CLP | | **7,793,646** | | 908,714 |
| Issuance of shares in Escal | | **139,445** | | – |
| Effect of change in ownership of non-controlling interest | | **174,215** | | – |
| Non-controlling interest in results of subsidiaries | | **(72,456)** | | – |
| Balance, end of year | $ | **11,981,554** | $ | 3,946,704 |

## 10. SEGMENTED INFORMATION

Activities of the Corporation and its subsidiaries focus on international petroleum and natural gas exploration and the development of a significant underground natural gas storage project in Spain. The Corporation's total identifiable assets by geographic area are as follows:

| As at December 31 | | 2007 | | 2006 |
|---|---|---|---|---|
| Spain | $ | **61,290,092** | $ | 38,715,782 |
| Tunisia | | **29,182,963** | | 22,161,090 |
| Canada | | **7,875,445** | | 18,337,386 |
| | $ | **98,348,500** | $ | 79,214,258 |

## 11. RELATED PARTY TRANSACTIONS

(a) Eurogas holds a $6 million revolving credit facility with Dundee Corporation ("Dundee"), the Corporation's principal shareholder. The entire $6 million was available as at December 31, 2007. The credit facility bears interest at the rate of prime (based on Canadian chartered bank rates) plus 2 percent per annum. Interest is payable monthly, in arrears. The credit facility is secured by a general security agreement over the assets of the Corporation.

Interest expense on amounts drawn on the facility and standby fees related to the credit facility totalled $60,000 during the year (2006 – $66,021).

The Corporation drew down on the facility by $1.0 million in January 2008 and an additional $500,000 in February 2008.

(b) On May 30, 1997, the shareholders of the Corporation approved an arrangement whereby the then Chairman and Chief Executive Officer of the Corporation purchased 1,000,000 common shares of the Corporation at a price of $1.00 per share. The Corporation agreed to provide this officer with a non-interest bearing loan of $1,000,000 to finance the purchase. On December 22, 2006, the Corporation forgave the remaining $800,000 outstanding. This amount was added to share capital and recognized as stock based compensation during 2006. All security held against the loan was released including 1,000,000 common shares of the Corporation. In addition in 2006, the Corporation accrued a bonus of $511,475 to the estate of the former Chairman and Chief Executive Officer.

(c) In September 2007, in order to satisfy the Spanish authorities of Escal's financial ability to undertake the project, Dundee provided a commitment letter to Escal and the Corporation, committing to either arranging for or providing financing for the project of €45 million ($65 million) until the projected completion of project financing and for the final equity requirement of €25 million ($36 million), if then required, subject to various conditions, including the grant of the Development Concession and other permits. A commitment fee of €70,000 ($101,000) was payable to Dundee by Escal at the time of signing the commitment letter. Such amount remains outstanding and bears interest at 6 percent per annum. In addition to the commitment fee, if funds are advanced pursuant to the commitment letter, Dundee is entitled to a drawdown fee from Escal of €350,000 ($505,000). In the event that the Development Concession is granted within 180 days of December 20, 2007, the ACS Transaction will come into effect and the commitment letter will no longer be in effect.

(d) Other related party transactions and balances not otherwise described or eliminated in these consolidated financial statements are as follows:

| As at and for the years ended December 31 | | 2007 | | 2006 |
|---|---|---|---|---|
| **EXPENSES** | | | | |
| Rent to an affiliate – Dundee Realty | **$** | **40,290** | $ | – |
| Administration and financing services to Dundee | | **606,287** | | – |
| **ASSETS** | | | | |
| Accounts receivable from Dundee | | **81,255** | | – |
| **LIABILITIES** | | | | |
| Rent payable to an affiliate – Dundee Realty | | **13,430** | | – |
| Accounts payable to Dundee | | **634,409** | | 5,096 |

These transactions were recorded at their exchange amounts.

## 12. DISCONTINUED OPERATIONS

Effective May 1, 2005, the Corporation relinquished all interest in Canadian oil and gas properties with the sale of its two remaining properties in Alberta and Saskatchewan. Operations related to these properties are presented as discontinued operations for 2006. Activity in 2007 was not significant.

## 13. SHARE CAPITAL

### a) Issued and outstanding shares:

| | Number of Shares | Amount |
|---|---|---|
| **Authorized:** | | |
| An unlimited number of common and first preference shares, issuable in series | | |
| **Issued and fully paid:** | | |
| Common shares, December 31, 2005 | 122,066,430 | $ 66,599,048 |
| Exercise of share options (i) | 1,358,333 | 342,377 |
| Rights offering costs (ii) | – | (22,035) |
| Forgiveness of share purchase loan (Note 11) | – | 800,000 |
| Common shares, December 31, 2006 | 123,424,763 | 67,719,390 |
| Exercise of share options (iii) | 1,150,000 | 179,400 |
| Common shares, December 31, 2007 | 124,574,763 | $ 67,898,790 |

(i) Includes $19,444 related to stock based compensation that was reclassified from contributed surplus to share capital as the options to which the stock related were exercised during 2006.

(ii) On October 21, 2005, the Corporation closed a rights offering to shareholders to subscribe for 24,348,286 common shares at a subscription price of $1.32 per common share. The share issue was fully subscribed raising a total of $32,139,738. Offering costs net of tax totalling $22,035 have been recorded as a reduction of share capital during 2006.

(iii) All share options exercised in 2007 were from options issued prior to the change in accounting rules which were effective January 1, 2003. Accordingly, no amounts had been reflected in contributed surplus and no transfer to share capital was required.

### b) Contributed surplus:

A summary of the changes in the Corporation's contributed surplus is as follows:

| As at and for the years ended December 31 | **2007** | 2006 |
|---|---|---|
| Balance, beginning of year | **$ 2,066,878** | $ 817,696 |
| Share options vested (i) | **1,951,691** | 1,186,726 |
| Deferred share units vested (ii) | **98,700** | 81,900 |
| Options exercised | **–** | (19,444) |
| Balance, end of year | **$ 4,117,269** | $ 2,066,878 |

(i) Stock based compensation expense of $1,162,323 was recognized during the year (2006 – $753,638) in association with share options. In addition, a total of $789,368 was capitalized to international asset pools, during the year (2006 – $433,088). Stock based compensation is based on the estimated fair value of options and deferred share units on the grant date in accordance with the fair value method and amounts are amortized over the vesting period of the option and deferred share units, respectively.

(ii) Stock based compensation expense of $98,700 was recognized during the year (2006 – $81,900) in association with deferred share units.

### c) Stock based compensation:

#### i. Share Option Plan

The Corporation has established a share option plan under which directors, officers, employees and consultants are granted options to purchase common shares of the Corporation. The number of shares issuable under the plan cannot exceed 12,000,000 in total, and the number of shares issuable to any one person under the plan cannot exceed 5 percent of the total number of common shares outstanding from time to time. The exercise price of each option equals the market price of the Corporation's stock on the date of grant and options are issued with a five-year expiry term. A summary of the status of the share option plan is as follows:

| | **2007** | | 2006 | |
|---|---|---|---|---|
| | **Share Options** | **Weighted Average Exercise Price** | Share Options | Weighted Average Exercise Price |
| Opening | **4,605,000** | **$ 1.10** | 4,700,000 | $ 0.72 |
| Granted | **2,750,000** | **1.12** | 1,330,000 | 1.59 |
| Exercised | **(1,150,000)** | **0.16** | (1,358,333) | 0.24 |
| Cancelled | **(200,000)** | **1.65** | (66,667) | 1.49 |
| Closing | **6,005,000** | **$ 1.27** | 4,605,000 | $ 1.10 |

As at December 31, 2007, options to purchase 3,321,667 common shares were exercisable as follows:

| Option Price | Options Outstanding | Options Exercisable | Remaining Contractual Life (Years) |
|---|---|---|---|
| $ 0.32 | 400,000 | 400,000 | 1.6 |
| $ 1.12 | 2,750,000 | 883,333 | 4.4 |
| $ 1.19 | 25,000 | 25,000 | 2.4 |
| $ 1.26 | 600,000 | 450,000 | 2.3 |
| $ 1.37 | 300,000 | 100,000 | 3.9 |
| $ 1.50 | 200,000 | 133,333 | 2.2 |
| $ 1.65 | 830,000 | 530,001 | 3.4 |
| $ 1.70 | 300,000 | 200,000 | 2.8 |
| $ 1.76 | 600,000 | 600,000 | 2.2 |
| | 6,005,000 | 3,321,667 | |

The estimated fair value of share options issued during the year was determined using the Black-Scholes model with the following weighted average assumptions:

| | **2007** | 2006 |
|---|---|---|
| Risk-free interest rate | **4.6%** | 6.0% |
| Expected hold period to exercise | **5 years** | 5 years |
| Volatility in the price of the Corporation's shares | **75.4%** | 77.6% |
| Dividend yield | **0.0%** | 0.0% |

ii. Deferred Share Unit Plan

During 2006, the Corporation established a deferred share unit plan ("DSUP") for eligible participants. The Compensation Committee of the Board of Directors administers the DSUP which is intended to provide participants with long-term incentive tied to the long-term performance of the Corporation's common shares. Once granted, directors will be entitled to payment in respect of units granted only when the director is no longer a director and ceases to be otherwise employed by the Corporation. Discretionary awards will be based on certain criteria, including services performed or to be performed.

The total number of deferred share units cannot exceed 4,000,000. As at December 31, 2007, 3,825,000 (2006 – 3,930,000) common shares remain available for grant under the DSUP.

d) Net earnings per share

The weighted average number of common shares outstanding for the year ended December 31, 2007 was 124,122,845 (2006 – 123,181,476). There were no dilutive options.

## 14. INCOME TAXES

The Corporation's future Canadian income tax assets are as follows:

| As at December 31 | 2007 | 2006 |
|---|---|---|
| Temporary differences related to: | | |
| Property, plant and equipment | **$ 67,729** | $ 108,000 |
| Share issue costs | **112,523** | 191,000 |
| Other | **12,875** | – |
| | **$ 193,127** | $ 299,000 |

The provision for income taxes differs from the amount computed by applying the combined Canadian federal and provincial tax rate of 32.12 percent (2006 – 34.49 percent) to the loss from continuing operations before taxes of $1,937,994 in 2007 (2006 – $2,366,828). The difference results from the following:

| For the years ended December 31 | 2007 | 2006 |
|---|---|---|
| Computed expected recovery of income taxes | **$ (622,484)** | $ (816,319) |
| Effect of taxes of: | | |
| International operations | **160,757** | 506,347 |
| Other differences | **84,034** | 103,768 |
| Non-deductible expenses | **419,496** | 288,177 |
| Provision for income taxes | **$ 41,803** | $ 81,973 |
| Represented by: | | |
| Current tax recovery | **$ (64,070)** | $ (35,027) |
| Future tax expense | **105,873** | 117,000 |
| | **$ 41,803** | $ 81,973 |

Costs related to international operations are considered pre-development costs and therefore not subject to tax.

## 15. SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION

Changes in non-cash working capital are comprised of the following:

| For the years ended December 31 | | 2007 | | 2006 |
|---|---|---|---|---|
| Accounts receivable | $ | (7,842) | $ | 99,919 |
| Prepaids and other | | (1,509,662) | | 305,390 |
| Joint venture receivable | | 463,382 | | 87,584 |
| Notes receivable – accrued interest | | (331,338) | | (55,353) |
| Accounts payable, accrued liabilities, advance from ACS and taxes payable | | 5,270,123 | | (145,957) |
| Change in non-cash working capital | | 3,884,663 | | 291,583 |
| Related to: | | | | |
| Financing activities | | (331,338) | | (55,353) |
| Investing activities | | 856,041 | | 950,363 |
| Operating activities | $ | 3,359,960 | $ | (603,427) |

The Corporation made the following cash outlays in respect of interest expense and income taxes:

| For the years ended December 31 | | 2007 | | 2006 |
|---|---|---|---|---|
| Interest expense | $ | 60,000 | $ | 66,022 |
| Income taxes | $ | 166,982 | $ | 52,126 |

## 16. COMPARATIVE FIGURES

Certain comparative figures have been reclassified to conform with the current year's presentation.

## 17. SUBSEQUENT EVENTS

(a) In January and February 2008, the Corporation drew down on its line of credit with Dundee Corporation for an aggregate of $1.5 million. The remaining available balance is $4.5 million.

(b) On March 14, 2008, the Corporation issued a Rights Offering Circular (the "Offering") for a maximum issue of 31,143,690 common shares to shareholders of record on March 27, 2008. Each shareholder is entitled to receive one transferable right ("Right") for each common share held. Four Rights entitle the holder to subscribe for and purchase one common share at a price of $0.97 per share on or before April 24, 2008 ("Basic Right"). Additional subscription privileges exist for each shareholder exercising all of its Basic Rights to subscribe for additional common shares, if any, not taken up on the expiry date.

The maximum gross proceeds of the Offering is $30,209,379 before deduction of estimated expenses of $250,000, excluding any fees or commissions which may be payable to the dealer manager of the Offering.

The gross proceeds of the Offering will be used to fund the exploration, evaluation and development of the Corporation's oil and gas assets and for working capital purposes.

## DIRECTORS

**Ned Goodman** [(1)(2)]
Chairman of the Board
Toronto, Canada

**M. Jaffar Khan**
President & Chief Executive Officer
London, England

**Derek H.L. Buntain** [(1)(2)]
George Town, Cayman Islands

**Jonathan Goodman**
Toronto, Canada

**R. James Kirker**
Calgary, Canada

**Garth A.C. MacRae** [(1)(2)]
Toronto, Canada

**Jay Poscente**
Calgary, Canada

[(1)] Audit Committee [(2)] Compensation Committee

## OFFICERS

**M. Jaffar Khan**
President & Chief Executive Officer

**Bruce W. Sherley**
Executive Vice President
& Chief Operating Officer

**Andrew E.W. Constantinidis**
Vice President
& Chief Financial Officer

**Donald R. Leitch**
Corporate Secretary

## AUDITORS

Ernst & Young LLP

## BANKERS

Dundee Corporation
Scotiabank

## RESERVE ENGINEERS

DeGolyer and MacNaughton
Canada Limited

## LEGAL COUNSEL

Carscallen Leitch LLP

## TRANSFER AGENT AND REGISTRAR

Computershare Investor Services LLC

## HEAD OFFICE

**Eurogas Corporation**
250, 435 – 4th Avenue S.W.
Calgary, AB, Canada T2P 3A8
Tel: (403) 264-4985
Fax: (403) 262-8299
Email: *eurogas@eurogascorp.com*
*www.eurogascorp.com*

## SPAIN OFFICE

**Escal UGS S.L.**
San Francisco de Sales 38
28003 Madrid, Spain
Tel: (+ 3491) 535 7701
Fax: (+3491) 535 2015

**Recaredo del Potro**
President

## TUNISIA OFFICE

**Eurogas International Inc.**
10 Rue 7000,
Bureau 44, 4ème étage
1002 Tunis – Belvédère
Tunisia
Tel: (+ 216) 71 890 551
Fax: (+ 216) 71 782 994
Email: *mkassar@gnet.tn*

**Madame Mélika Kassar**
Representative

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Eurogas

250, 435 – 4th Avenue S.W.,
Calgary, AB Canada T2P 3A8
Tel: (403) 264-4985
Fax: (403) 262-8299
Email: eurogas@eurogascorp.com
**www.eurogascorp.com**